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ABSTRACT

The Subcommittee met to hear testimony on the college student loan process, particularly whether, at a time of devolution of power to state and local levels, it is contradictory to continue with the relatively new Federal Direct Student Loan Program. Chairman Peter Hoekstra outlined how vital higher education has become for access to quality employment and the possible problems with direct federal lending. Representative Sawyer responded with positive information on the Ford program and a recommendation for no major adjustments. Representative Petri critiqued the program and suggested reform measures. Representative Istook testified that the direct lending program is a mistake and that this function should be privatized. Senator Paul Simon testified in support of direct lending citing feed-back from institutions that have participated. Representative Bart Gordon urged further testing of direct lending before allowing full implementation. A representative of Maine Education Services, a secondary market lender, testified on the success of that program. Financial aid directors from Hope College (Michigan), California State University, Northridge; and Roger Williams College (Rhode Island) also testified on their experience with the direct lending program. Extensive additional materials and prepared statements are included. (JB)

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HEARING ON FEDERAL STUDENT LOAN PROGRAMS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON ECONOMIC AND EDUCATIONAL OPPORTUNITIES

HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, MAY 23, 1995

Serial No. 104–27

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HEARING ON FEDERAL STUDENT LOAN PROGRAMS

TUESDAY, MAY 23, 1995

House of Representatives, Subcommittee on Oversight and Investigations, Committee on Economic and Educational Opportunities, *Washington, DC.*

The subcommittee met, pursuant to call, at 1:30 p.m., Room 2175, Rayburn House Office Building, Hon. Peter Hoekstra, Chairman, presiding.

Members present: Representatives Hoekstra, Barrett, Ballenger, Cunningham, McKeon, Weldon, Goodling, Sawyer, Roemer, Scott, Green, and Reynolds.

Staff present: Emilia DiSanto, Professional Staff Member; Derrick Max, Professional Staff Member; John Straub, Budget Analyst; Leigh Lanning, Legislative Assistant; Sally Stroup, Professional Staff Member; and Richard Jerue, Professional Staff Member.

Chairman HOEKSTRA. The subcommittee will now come to order.

Good afternoon. I'd like to welcome all of you for this meeting of the Oversight and Investigations Subcommittee to discuss the involvement of the Federal Government in the student loan process.

Student access to higher education is an important issue, particularly as the job market requires increased education for hiring. Forty or 50 years ago, few people needed more than a high school diploma to provide for his or her family. This is not the case today.

Many employers consider a college degree a prerequisite for employment, and a graduate degree is becoming increasingly essential to land a job in several careers.

With this being the case, access to a college education is a continuing concern for students and their families and for this Congress. Tuition costs at many public and private colleges and universities have increased far faster than the inflation rate over the past decade.

As a result, a large percentage of students now must borrow money to continue on to college or graduate school. It is a very expensive proposition.

Over the years, many vehicles have emerged to help students and families obtain the necessary funds to continue higher education. Two years ago, Congress passed legislation to initiate the Federal Direct Student Loan Program. Today this program operates side by side with the Federal Family Education Loan Program that has existed since 1965.

There has been fierce criticism over the cost of the Federal Direct Student Loan Program over the past year or so. It is unclear just how much this program will cost the Federal Government in the long run, despite early estimates of savings.

Concerns have also been raised about the direct involvement of the Federal Government in the program. In this time of devolution of power and responsibility to State and local officials, it seems contradictory to place a program of this magnitude firmly in the hands of the Federal Department of Education, but then the question arises: How private is private?

There are innate problems that exist with the FFEL today that must be addressed. I would encourage the panelists to address the question of Federal involvement in the FFEL compared to the Direct Loan program. Must we move to a totally federally run program just to avoid problems under the existing structure? I would like to explore the options.

This Congress is intent on reducing spending so that our children are not harnessed with an enormous debt. It is essential that any Federal involvement in student loans address the needs of families without contributing to the tax burden and long term indebtedness of tomorrow's families. How do we balance this?

To further focus our discussion, I'd like to reiterate the principles that we have followed in our committee's work:

> We must ensure that the programs and regulations we oversee: Focus on the appropriate Federal mission; work effectively and efficiently; consistently follow Congressional intent; establish a framework for policy initiatives that will create an environment for life-long learning and effective workplace policy; and provide for a Federal Government role only where absolutely necessary.

All that being said, I would now like to recognize my colleague and Ranking Member, Mr. Sawyer, for his opening statement.

[The prepared statement of Mr. Hoekstra follows:]

STATEMENT OF HON. PETER HOEKSTRA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Good morning. I'd like to welcome you all for this meeting of the Oversight and Investigations Subcommittee to discuss the involvement of the Federal Government in the student loan process.

Student access to higher education is an important issue, particularly as the job market requires increased education for hiring. Forty or 50 years ago, few people needed more than a high school diploma to provide for his or her family. This is not the case today. Many employers consider a college degree a prerequisite for employment and a graduate degree is becoming increasingly essential to land a job in several careers.

With this being the case, access to a college education is a continuing concern for students and their families. Tuition costs at many public and private colleges and universities have increased far faster than the inflation rate over the past decade. As a result, a large percentage of students now must borrow money to continue on to college or graduate school. It is a very expensive proposition.

Over the years, many vehicles have emerged to help students and families obtain the necessary funds to continue higher education. Two years ago, Congress passed legislation to initiate the Federal Direct Student Loan Program. Today this program operates side by side with the Federal Family Education Loan Program [or the FFEL] that has existed since 1965.

There has been fierce criticism over the cost of the Federal Direct Student Loan program over the past year or so. It is unclear just how much this program will cost the Federal Government in the long run, despite early estimates of savings. Concerns have also been raised about the direct involvement of the Federal Government in the program—in this time of devolution of power and responsibility to State and local officials, it seems contradictory to place a program of this magnitude firmly in the hands of the Federal Department of Education.

But then the question arises: How private is private? There are innate problems that exist with the FFEL today that must be addressed. I would encourage the panelists to address the question of Federal involvement in the FFEL compared to the Direct Loan program. Must we move to a totally federally run program just to avoid problems under the existing structure? I would like to explore the options.

This Congress is intent on reducing spending so that our children are not harnessed with an enormous debt. It is essential that any Federal involvement in student loans addresses the needs of families without contributing to the tax burden and long-term indebtedness of tomorrow's families. How do we balance this?

To, further focus our discussion I'd like to reiterate the principles that we have followed in our committee's work.

We must ensure that the programs and regulations we oversee:

1. Focus on the appropriate Federal mission;
2. Work effectively and efficiently;
3. Consistently follow congressional intent;
4. Establish a framework for policy initiatives that will create an environment for life-long learning and effective workplace policy;
5. Provide for a Federal Government role only where absolutely necessary.

All that being said, I now would like to recognize my colleague and Ranking Member, Mr. Sawyer, for his opening statement.

Mr. SAWYER. Thank you, Mr. Chairman. I appreciate your taking the time and effort to schedule this hearing to review the status of an enterprise that, in its largest sense, is important to millions of people all across the country.

The direct lending program is about to enter its second year of operations. Nearly 1,500 schools will participate in the program in the coming year, representing about 40 percent of the total loan volume in the country. Applications are being accepted for a third year.

The issues that you raise in the light of this are all very important. The evidence I have reviewed so far clearly suggests that the Direct Student Loan Program is working well so far. Recent independent surveys indicate that the 104 schools that participated this first year were extremely pleased, rated the program as exceptional, and cited the faster receipt of loan funds, thereby increasing cash flow for schools and students, [lower personnel costs], I think quite to the surprise of a number of people, and a better understanding of the loan process among borrowers.

Given those high marks, I suspect that it would be premature to make large adjustments in the planned phase-in of the program right now. The second phase in the coming school year will give us additional opportunity to examine the benefits of the program and any potential problems that might arise, but I think even more importantly, it will give us an opportunity to observe—Let me just pause for a moment.

At the end of my statement, I was going to thank our colleagues, Mr. Gordon, Mr. Petri, Mr. Istook, for being here. So before you go running off, just let me say thank you, in the event I'm not here when you get back.

It will give us a chance to observe and compare both lending programs in an environment of comparable loan volume. I think that's important in order to come to grips with those things that work well and those that don't in both programs, because schools continue to have the option to choose. We can explore more thoroughly the factors that influence that choice and the relative ability of each program to meet the needs of borrowers.

That parallel operation under currently authorized timelines, I hope, would allow us to gather the kind of information about the questions that you, Mr. Chairman, have raised and on which we are going to have to come to informed judgments about the future of student financial aid.

In the meantime, I hope we'll continue to watch the implementation of the direct lending program carefully to ensure that the Department is carrying out its mandate in the manner that Congress intended, as well as to monitor and compare the program's performance from both an operational and physical standpoint.

In that sense, Mr. Chairman, let me again thank you. I look forward to the testimony of all of our witnesses, and I assume at this point we can head toward the floor and get our obligations out of the way there.

Chairman HOEKSTRA. Well, I thought we would introduce the first panel, and since they weren't here, we would go right to the second panel. Thank you very much for that opening statement.

We do have a vote on the floor on the rule. Before we do that, any other members can submit opening statements. We can go vote on the rule. I believe that allows then for at least two hours of general debate. So for all of you that are eagerly awaiting this hearing, we'll be gone for about 15 minutes, and then we can have uninterrupted attention on this issue for around two hours.

So the committee will recess.

[Recess.]

Chairman HOEKSTRA. I would like to welcome the first panel. Before I introduce the first panel, I would like to yield for my colleague from California who is going to prompt the first panel and introduce a witness from the second panel since he won't be here to introduce her at that time. Mr. McKeon.

Mr. MCKEON. Thank you very much, Mr. Chairman. Not to detract at all from the first panel, they are great distinguished guests, but it's sure nice to have somebody from out in the outer world, and we do have Dr. Diane Ryan who works at Cal State University Northridge in my district, achieved great notoriety and fame during the earthquake a couple of years ago.

She is the Director of Financial Aid there, and has a lot of experience in this area. I just am happy to be here to welcome her, and apologize that I will have to leave, but I know that she will be an outstanding witness and a good addition to this panel, and I am also glad to see these other distinguished gentlemen here, too.

Thank you.

Chairman HOEKSTRA. Thank you, Mr. McKeon.

I'd like to—I'll be very brief in my introductions of the first panel. They are distinguished guests, I think well known to all of us: Mr. Petri, Mr. Istook, Mr. Simon, and Mr. Gordon.

Welcome. We are looking forward to your testimony. We'll begin with you, Mr. Petri.

STATEMENT OF HON. THOMAS E. PETRI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. PETRI. Thank you very much. I appreciate the opportunity to have a chance to make a few points in connection with the guaranteed student loan programs. I have six points to make.

First, guaranteed loans are not a private sector program.

Second, direct lending is a public/private partnership.

Third, the key difference between the two is the method for pricing private sector services, through a competitive bid process under direct lending, and through a political negotiation under guaranteed loans.

Fourth, because direct lending is far simpler in structure, it involves less bureaucracy and fewer Federal employees than guaranteed lending.

Fifth, the current scoring of direct lending by the CBO understates, not overstates—understates its savings by billions of dollars.

Sixth, if we take student loan reform to its logical conclusion, direct lending can be even simpler and more cost effective than it already is.

Let me touch on each of these points. First, I'd like to say that I certainly believe I'm a privatizer, and I bow to no one in that regard; but what I'd like to say here is that I would be all for a truly private student loan program, but that's not what we have, and for very simple reasons.

Students use the loans to invest in human capital, but they can't pledge their human capital as collateral. Loans to most of them are, therefore, too risky for private lenders. So the government has stepped in to provide a 98 percent guaranty and serve the appropriate function of spreading these risks across all student borrowers.

The government also determines maximum loan amounts and eligibility, both of students and of schools, and because lenders have no incentive to be diligent collectors of fully guaranteed loans, partly to oversee them, the government has established a network of guaranteed agencies that spend Federal money but are not really accountable to anyone but themselves.

Make no mistake. This is a government program and a "Rube Goldberg" one at that. In it, the private sector performs two principal functions, providing capital and servicing the loans. The first of these is unnecessary. The government can sell T–bills to the private sector rather than providing an alternative investment vehicle, student loans, with all the attributes of T–bills.

The second function, loan servicing, is still provided by the private sector under the current version of direct lending. The key difference is how this function is priced. Under direct lending, that's done in a market process through competitive bidding. Under guaranteed lending, it's done in a political negotiation over the loan interest rate when we reauthorize the Higher Education Act. I've been in a couple of those negotiations and reauthorizations.

A little history might be instructive here. When I first joined this committee 16 years ago, the banks got 3.5 percent over the T–bill interest rate on these loans, and at that time they swore on a stack of Bibles that, if we lowered that differential below 3.5 percent, tanks would drop out and students couldn't get loans.

Then we lowered it to 3.25 percent, and guess what? Nobody dropped out, but they swore on a stack of Bibles that if we lowered it from 3.25, they would drop out and students couldn't get loans, and we lowered it, with much gnashing of teeth, to 3.1 percent, and guess what? Nobody dropped out, and they swore on a stack of Bibles that if we lowered the in-school differential below 3.1, banks would drop out and students couldn't get loans, but we lowered that to 2.5 percent, and guess what? Again nobody dropped out. If we threaten to lower these rates further today, is there any doubt what the banks would say? They would swear on a stack of Bibles—and you get the point.

Now how much further down could we go? How do you find out in this process? Only by calling the banks' bluff little by little again and again until some banks do start to drop out. A Wall Street securities analyst covering Sallie Mae recently wrote that Sallie's cost of servicing loans is about ¾ of a percent, which suggests that the differential could get closer to 1.1 percent than 3.1 percent.

Well, it's taken us 16 years to get from 3.5 to 3.1, and I for one don't have 80 more years left to go from 3.1 to 1.1.

Now I don't blame the banks for negotiating the best deal that they can, but I ask you, my colleagues, what's the best way to figure out how much to pay the private sector for loan servicing, continuing this arduous political negotiation process or separating the servicing function from the capital provision function and conducting a simple competitive bidding process?

That's the key question at the heart of the debate over direct lending. As a dedicated fiscal conservative, I have no trouble answering it, and I don't think others should either.

Notice that a direct loan servicer has an incentive to do a good job so that he can compete for another contract. In the guaranteed program, despite the whole unwieldy guarantee agency structure to enforce government due diligence regulations, there's actually an incentive to allow defaults to occur, since the guarantee agencies get to keep 27 cents of every dollar that they collect after a default, and most of what they don't collect is re-guaranteed by the Federal Government.

The guarantee agency costs should also count in the debate over scoring. It's true that adding in the net present value of all future administrative costs on direct loans reduces the direct loan savings, but those savings are still huge; and if we are going to fool around with the scoring, let's be fair.

Let's make sure we include on the guaranteed loan side all the Department's costs to oversee guaranteed loans and all the guarantee agency costs, including $[illegible]00 million per year of diverted collections on defaulted loans.

Far more important, let's use the appropriate Federal cost of capital for direct loans, which is the 91 day T–bill rate, rather than, as CBO does, a 10-year rate, which is 1.5 percentage point above, and therefore, a huge overstatement of the cost.

I do believe direct loans can be improved through further reforms, which I plan to offer when this committee marks up its reconciliation instructions. First, we should base any interest subsidies on the student's wherewithal to repay the loan, which is her own post-school income. Then there will be just one loan program with a single set of terms and no need to test at the front end, a further simplification.

Again, with a workable income-dependent repayment option, there is no need for deferment and forbearance provisions, since anyone who needs deferment or forbearance will get it automatically. That's another great savings in bureaucracy.

Finally, it makes sense for students selecting income-dependent repayment to agree to have their repayments considered as income taxes and collected along with the rest of their income taxes by the IRS through an adjustment in their withholding rate. Then there are no more monthly checks to write or to receive and document.

As an addition to income tax payment, which is going on anyway, the marginal cost of this form of student loan repayment should be close to zero, and it also makes sense theoretically. The students borrow partly to achieve higher incomes, and they agree to pay higher income taxes for a time in return for this investment.

Under existing law, all those in default under repayment options can be placed in income-dependent repayment, where we can at least keep them paying whatever they can afford, and the government will get 100 percent of what they pay. This should lower default costs substantially.

Mr. Chairman, through further reforms we can attack all four sources of waste in student loans: Excess payments to lenders, default costs, mistargeted subsidies to students, and excessive complexity and bureaucracy. Direct lending is a vital component which must be defended.

Thank you very much for your indulgence.

Chairman HOEKSTRA. Thank you.

[The prepared statement of Mr. Petri follows:]

Statement of Hon. Thomas E. Petri, a Representative in Congress from the State of Wisconsin

Mr. Chairman, I appreciate this opportunity to offer my thoughts on the issue of direct versus guaranteed student loans. I'd like to make six points:

First, guaranteed loans are not a private sector program.

Second, direct lending is a public/private partnership.

Third, the key difference between the two is the method for pricing private sector services: through a competitive bid process under direct lending, and through a political negotiation for guaranteed loans.

Fourth, because direct lending is far simpler in structure, it involves less bureaucracy and fewer Federal employees than guaranteed loans.

Fifth, the current scoring of direct lending by the CBO understates its savings by billions of dollars.

Sixth, if we take student loan reform to its logical conclusion, direct lending can be even simpler and more cost-effective than it already is.

Let me touch on each of these points.

First, as a privatizer, I bow to no one. In fact, I am leading an effort to privatize the regulation of the banking industry, along with its deposit insurance, but so far the banking lobbies prefer service to the Pharaohs over journeying to the promised land of the free market. I'd be all for a truly private student loan program, but that's not what we have, and for a very simple reason. Students use the loans to invest in human capital, but they can't pledge their human capital as collateral. Loans to most of them are therefore too risky for private lenders, so the government has stepped in to provide a 98 percent guarantee and serve the appropriate function of spreading these risks across all student borrowers. The government also determines maximum loan amounts and eligibility, both of students and of schools. And because lenders have no incentive to be diligent collectors of fully guaranteed loans, partly to oversee them the government has established a network of guarantee agencies that spend Federal money but are not really accountable to anyone but themselves.

Make no mistake. This is a government program, and a Rube Goldberg one at that. In it, the private sector performs two principal functions: providing capital and servicing the loans. The first of these is unnecessary; the government can sell T-bills to the private sector rather than providing an alternative investment vehicle—student loans—with all the attributes of T-bills [low risk, full liquidity, no expense while the student is in school, and interest rates tied to T–bills but 2.5 percent higher]. The second function, loan servicing, is still provided by the private sector under the current version of direct lending. The key difference is how this function is priced. Under direct lending, that's done in a market process through competitive bidding. Under guaranteed lending, it's done in a political negotiation over the loan interest rate when we reauthorize the Higher Education Act.

A little history might be instructive here. When I first joined this committee 16 years ago, the banks got 3.5 percent over the T–bill interest rate on these loans, and they swore on a stack of Bibles that if we lowered that differential, banks would drop out and students couldn't get loans. Then we lowered it to 3.25 percent. And guess what? Nobody dropped out. But they swore on a stack of Bibles that if we lowered it from 3.25, they would drop out and students couldn't get loans. Then we lowered it, with much gnashing of teeth, to 3.1 percent. And guess what? Nobody dropped out! And they swore on a stack of Bibles that if we lowered the in-school differential below 3.1 percent, banks would drop out and students couldn't get loans. But we lowered that to 2.5 percent. And guess what? Nobody dropped out! If we threatened to lower these rates further today, is there any doubt what the banks would say? They'd swear on a stack of Bibles . . . but you get the point.

Now how much further down could we go? How do we find out in this process? Only by calling the banks' bluff little by little again and again until some banks do start to drop out. A Wall Street securities analyst covering Sallie Mae recently wrote that Sallie's cost of servicing loans is about ¾ of a percent. That suggests the differential could go closer to 1.1 percent than 3.1 percent. It's taken us 16 years to get from 3.5 to 3.1. I don't have 80 more years to get from 3.1 to 1.1, even without term limits.

Now I don't blame the banks for negotiating the best deal they can. But I ask you, Mr. Chairman, what's the best way to figure out how much to pay the private sector for loan servicing—continuing this arduous political negotiation process, or separating the servicing function from the capital provision function and conducting a simple competitive bidding process? That's the key question at the heart of the debate over direct lending. As a dedicated fiscal conservative, I have no trouble answering it. and you shouldn't either.

Notice that a direct loan servicer has an incentive to do a good job so that he can compete for another contract. In the guaranteed program, despite the whole unwieldy guarantee agency structure to enforce government "due diligence" regulations, there's actually an incentive to allow defaults to occur, since the guarantee agencies get to keep 27 cents of every dollar they collect after a default, and most of what they don't collect is re-guaranteed by the Federal Government. For this and other reasons, under 100 percent direct lending, we can eventually eliminate the guarantee agencies and their 5,000 indirectly federally paid employees—an immense savings in bureaucracy. At the same time, the Department of Education's student loan workforce is projected to go down, not up, because it is much easier to supervise a few contractors who have appropriate incentives than it is to oversee 7,800 lenders and 41 guarantee agencies who have all the wrong incentives.

The guarantee agency costs should also count in the debate over scoring. It's true that adding in the net present value of all future administrative costs on direct loans reduces the direct loan savings. But those savings are still huge. And if we're going to fool around with the scoring, let's be fair. Let's make sure we include on the guaranteed loan side all the Department's costs to oversee guaranteed loans and all the guarantee agency costs, including $300 million per year of diverted collections on defaulted loans.

And far more important, let's use the appropriate Federal cost of capital for direct loans. Currently the CBO uses the rate on 10 year treasury notes, since that is the debt of comparable maturity to student loans. That would be appropriate if student loan interest rates were fixed, like the 10 year note rate, but they are not. They are variable, based on 91 day T–bills. Therefore student loans carry no interest rate risk, except for the upper limit which should be scored separately. The reason 10 year note rates average 1.5 percent or so higher than T–bill rates is that they carry interest rate risk. Investors demand a higher rate in exchange for tying up their money for so long at a fixed interest rate because the value of the note will go down if interest rates rise. There is no such risk with student loans because their interest is variable. It's not right to count a long term fixed interest rate as the cost of capital on a variable rate loan tied to short term rates when the main reason the long term rate is higher is because it is fixed. Therefore the government's cost of capital for direct loans really is the rate on the instrument to which their interest is tied, which is 91 day T–bills. With that scoring change, the savings from direct lending would at least double. So, Mr. Chairman, if the defenders of guaranteed loans want to change scoring, let's just do it fairly and completely and guaranteed loans will be blasted out of the water.

I do believe direct loans can be improved through further reforms, which I plan to offer when this committee marks up its reconciliation instructions. First, we should base any interest subsidies on the student's wherewithal to repay the loan, which is her own post-school income. Then there will be just one loan program with a single set of terms and no needs test at the front end, a further simplification. Again, with a workable income-dependent repayment option, there is no need for deferment and forbearance provisions, since anyone who needs deferment or forbearance will get it automatically. That's another great savings in bureaucracy.

Finally, it makes sense for students selecting income-dependent repayment to agree to have their repayments considered as income taxes and collected along with the rest of their income taxes by the IRS through an adjustment in their withholding rate. Then there are no more monthly checks to write or to receive and document. The IRS has no need to know which dollars are which as they are coming in—the dollars are allocated and loan accounts simply reconciled at the end of the year when Form 1040s are filed. Borrowers can change their repayment rates at any time without telling anyone as long as they pay at least the minimum called for under the income-dependent option. As an addition to income tax payment which is going on anyway, the marginal cost of this form of student loan repayment should be close to zero. And it also makes sense theoretically. The students borrow partly to achieve higher incomes and they agree to pay higher income taxes for a time in return.

Under existing law, all those who default under other repayment options can be placed in income-dependent repayment, where we can at least keep them paying whatever they can afford and the government will get 100 percent of what they pay. This should lower default costs substantially.

Mr. Chairman, through further reforms, we can attack all four sources of waste in student loans: excess payments to lenders, default costs, mistargeted subsidies to students, and excessive complexity and bureaucracy. Direct lending is a vital component which must be defended

Mr. HOEKSTRA. Mr. Istook.

STATEMENT OF HON. ERNEST ISTOOK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA

Mr. ISTOOK. Thank you, Chairman Hoekstra. You know, I'm pleased to be able to talk about student loans. I certainly have a personal interest. This fall I will have two of my children in college. Next year another one of my children will begin college. The year after another one plans to enter college, and two years after that, finally, the youngest, Emily, should enter college as well. So anything that relates to college financing certainly is very, very dear to my heart.

I am one of over four dozen Members of this body who have come to the conclusion that the Federal Direct Student Loan Program which was enacted two years ago is a mistake that needs to be corrected. The direct government loan program, of course, I think, is being implemented too quickly, and both Federal funds, Federal budgeting, and the educational opportunities of students are being jeopardized.

I'm the sponsor of legislation, the Student Loan Privatization Act of 1995, H.R. 1501, calling for a phase-out of the direct lending program. I'd like to explain why.

I believe there are three principles which should guide our consideration of student loans and other education policy on the Federal level:

> First, the Federal Government should only carry out those responsibilities which cannot be performed by the private sector.

Second, programs should be structured to minimize Federal employment, whether it's direct, as reflected in the number of additional bureaucrats at the Department of Education, or indirect, through government contractors.

Third, the opportunity for private sector participation in a Federal program should be structured in a way that allows for innovation and efficiency.

I believe the Federal Direct Program violates these three principles. It was enacted as part of the Clinton Administration's massive budget bill in 1993. It was not subjected to any in-depth examination or hearings and, frankly, I do not believe it would have been enacted had it not been buried within this larger budget legislation. Indeed, I believe 285 Members of Congress had signed a letter indicating opposition to the direct lending program.

It was unfortunate also that it was passed less than a year after Congress had sought to test the waters through pilot projects created in 1992. Direct lending is a government run, multi-billion dollar consumer loan program. It seems to be based on three assumptions with which I very much disagree.

The first assumption is that a sole source government monopoly would be more efficient and more consumer oriented than the private sector. I don't think we've had that experience any place else within the government.

The second assumption is that the Federal Government is efficient at collecting loans. I think the default rates even on the student loan programs historically show that this is not the case.

The third assumption is that a centralized administration of a program would ensure accountability and innovation, which flies in the face of the fact that competition is usually what spurs accountability and innovation and, when you do away with competition in a sector of lending or anything else, you do away with innovation.

Now we have heard that some schools like direct government loans, but let's look at the facts on that. There have only been about 100 schools participating originally. They have been able to claim $400 million or so in Federal dollars for administrative expense. Of course, they like that opportunity for themselves; but if you spread that same $400 million over 1,500 schools to be involved, I think you would find that desire to participate would be greatly diminished.

The crux of the problem, of course, has to do with the costs of the overhead and the cost to the taxpayer, what it does on the deficit, and also putting schools in the business of being direct lenders when that is not their business. Bankers, savings and loan officers, investment institutions—they are accustomed to being lenders. A school, a university does not have that as its principal way of doing business, and they are not anxious to gain that expertise which is much more readily available and much superior in the private sector.

That is one of the reasons why the Board of Regents in the State of Oklahoma for all the Oklahoma institutions of higher education is on record as opposing the takeover of the student lending program by the direct lending program.

We hear that the program supposedly is saving more than $12 billion over a five-year period, but Mr. Chairman, the Department of Education itself has admitted that the current Act fails to account for the administrative costs which are associated with direct government student loans.

The Department itself, when it was criticizing a bill sponsored by Chairman Goodling, admitted that the bill does not actually increase the Federal costs by doing away with direct lending, but changing when the costs are realized.

Budget scoring distortions are being produced under the current Federal Credit Reform Act, and it only makes it appear that direct lending is cheaper than a private sector based program. The work of the Congressional Research Service on student loans substantiates this.

Recently, a paper they produced for Congressman Gordon unambiguously states as follows: "There may be a logical rationale for direct lending, but low cost is not it."

To make the revenue stream to the government appear better than it really is, the administration has used 90-day Treasury note interest rates for projections regarding loans that are actually on the books for 10 years, not for 90 days. That results in a 2 percentage point differential in projections of interest rates and projections of savings. It does not take into account the true risk that the government is experiencing.

Also, if you change from a program where the government has a contingent liability to direct lending, the taxpayer is now liable for 100 percent of the amount of the loan, not just the portion which may be involved in the default.

I have a chart which is attached with my testimony. I would like to focus your attention on it, Mr. Chairman. Mr. Chairman, very briefly, if you look at the chart here, you will find the dark blocks are the new loans that are made under this program each year from 1995 to the year 2014. The smaller lines which begin after repayment begins, the smaller blocks, the white blocks, are payments received, principle and net interest.

So you have this amount each year, the dark block, that has to be borrowed, and the white block, which is receipts coming back into the government. Because each year you have to borrow more than you receive—For example, in 1995 new loans $4 billion, principle and net interest, zero. By the year 2000 new loans being made, $34 billion, payments of principle and interest only $9 billion. By 2014 when the program would be fully implemented, new loans being made, $68 billion a year, payments coming back in only $52 billion a year.

Each year, whether it be $4 billion or $20 billion or ultimately $16 billion a year, it all goes directly to the annual deficit. It all goes directly to the national debt, and the cumulative effect as you add these increasing debts on top of each other is, as this chart shows by the year 2014, you have almost a $350 billion addition to the national debt because of the extra money that is borrowed by the Federal Government for direct lending program instead of having loans being made by private lenders.

Mr. Chairman, I'm concerned also about how the Department of Education is marketing the program. Direct lending supposedly is a breakthrough in simplifying administration, but they are using substantial sums for newspaper advertisements, contracting with an advertising firm out of New York City, sending dozens of Department of Education employees to financial aid conferences, trying to sell the program, which supposedly would be so superior that it doesn't need to be sold.

I'm concerned about the types of schools that are anxious to get into direct loans. Congressman Gordon, I believe, has documented that a disproportionate number of high default schools have applied for or been accepted into the program, that the safeguards are diminished under direct lending when there is direct access to taxpayers' funding to the vault of the United States Treasury.

Third, I am very concerned about the level of responsibility placed within the Department of Education. It has a record of inefficient administration. I do not believe that the management programs—I'm sorry, the management problems which already exist at the Department of Education have disappeared, much less when you add an additional 520 new Federal workers at the Department of Education to administer this program, again all at direct expense to the taxpayers.

I do not see any evidence, Mr. Chairman, that the Department of Education is doing a better job in policing the types of schools or the administration of the programs that are involved in this. I believe it's time for us to admit the mistake that was made when, without proper hearings, without proper deliberation, without proper oversight, direct loans were adopted in 1993, more or less hidden within much larger legislation.

Mr. Chairman, I would certainly urge and hope that this subcommittee and full committee will work to bring back a private student loan program where the taxpayer may be at risk for a guaranty but not for the full amount of a loan and the incredible impact which it has on our national debt.

Thank you, Mr. Chairman.

Chairman HOEKSTRA. Thank you, Mr. Istook.

[The prepared statement of Mr. Istook follows.]

STATEMENT OF THE HONORABLE ERNEST ISTOOK

Mr. Chairman, I am pleased to speak with you today regarding the federal student loan programs. I congratulate you on holding this hearing on an area of federal policy so important to America's future.

I am one of over four dozen members of the House of Representatives who have come to the conclusion that the Federal Direct Student Loan Program enacted two years ago is a mistake and that corrective action needs to be taken. The direct government loan is being implemented too quickly. Federal funds and the educational opportunities of students are being placed in jeopardy.

My bill, The Student Loan Privatization Act of 1995 (H.R. 1501) calls for a phase-out of the Federal Direct Student Loan Program. This approach reflects an unambiguous vision of the direction in which federal student policy should be moving. I would like to explain why I, and my colleagues, believe we should move immediately to terminate the direct loan program.

There are three principles that I believe should guide our consideration of student loans and other federal education policy:

- First, the Federal government should only carry out those responsibilities that cannot be performed by the private sector;
- Second, programs should be structured to minimize federal employment, whether that employment is direct--as reflected in the number of bureaucrats at the Department of Education--or through government contractors; and
- Third, the opportunity for private sector participation in federal programs should be structured to promote innovation and efficiency.

Mr. Chairman, the William D. Ford Federal Direct Student Loan Program violates all three of these principles. That is why I propose eliminating this cumbersome federal program.

The Direct Loan Program was enacted as part of the Clinton Administration's massive budget bill in 1993. It was not subject to any in-depth examination or hearings and, in my view, would not have been enacted if it had not been buried in the larger budget legislation. It was adopted less than a year after Congress passed legislation to test direct government student lending in a pilot project in 1992. That was unfortunate.

Direct lending is nothing more than a government-run, multi-billion dollar consumer loan program. It is premised on three assumptions:

- Sole-source government monopolies are more efficient and customer-oriented than the private sector; (This has yet to be proven true, given our experience with Public

Housing, the Tennessee Valley Authority, and other government monopolies.)

- The federal government is an efficient collector of loans (We have problems collecting other debt owed to the government.); and

- Centralized administration of a program is consistent with assuring accountability and continued innovation (This flies in the face of all that the private sector is currently experiencing with their rightsizing and decentralization efforts made necessary by international competition and information technology).

Mr. Chairman, we have heard much over the last few months about the initial success of the direct loan program and the savings it has allegedly produced. These claims would be amusing if they were not being used to justify the massive expansion of the federal government now underway at the Department of Education.

First, we hear that schools like direct government loans. Let us examine this.

I was unaware that anyone on Capitol Hill doubted the federal government was efficient in giving away money. Unfortunately, it is this aspect of the direct loan program that is getting the rave reviews from schools and others--schools are getting student loan funds to their students with less paperwork and less hassle than before: That is the crux of the success story for direct loans. In fact, there are numerous higher education organizations opposing direct lending. My own Board of Regent in the State of Oklahoma is on record as opposing this takeover.

But what about the repayment process? **Can anyone here show me a federal loan program where getting loan recipients to repay their loans has not been a problem?** Loans made under the direct government loan program are only now entering repayment. Only after we get significant feedback on the repayment process will any meaningful statement be possible on the "success" of the program. At this point, all we can say is that the Department of Education has proven again it is good at giving money away. The real test will be whether they can convince students to repay.

Second, we hear that the program "saves" more than $12 billion over a five year period.

Mr. Chairman, the **Department of Education itself has admitted that the current Credit Reform Act fails to account for the administrative costs associated with direct government student loans.** Ironically, in criticizing Chairman Goodling's bill, the Department itself admits that the amendment proposed to the Credit Reform Act in that bill does not increase federal costs, **but merely the point in time at which they are recognized.** This is a $4.5 billion distortion over 5 years that the direct lending program is not showing as a cost of the program. It is thus impossible to compare one program to the other under current credit reform rules.

Given the budget scoring distortions produced under the current Federal Credit Reform Act, is it any wonder that direct government lending appears cheaper than the private sector-based program?

More important perhaps than any analysis of Credit Reform is the work of the Congressional Research Service on the subject of student loans. The paper recently produced for Rep. Gordon unambiguously states the following: "There may be a logical rationale for direct lending, but low cost is not it."

To make the revenue stream to the government appear better than it really is, the administration has used 90-day Treasury note interest rates for loans that are actually on the books for 10 years. This results in a 2 percentage point difference in interest rates. It certainly does not take into account the risk the government is experiencing as a result of the dramatic increase in lending the pilot schools have experience (in the neighborhood of a 20% increase in the amount of direct lending.)

Finally, one item that greatly disturbs me is the move from a Guaranteed Student Loan program, where the government has a contingent liability, to a Direct Student Loan program where the taxpayer is liable for 100% of the amount of the loan, not just the default portion. The chart with me today, "Direct Lending's Impact on the National Debt," demonstrates this clearly. Using conservative assumptions throughout, assumptions clearly listed on the graph included with my testimony, after 20 years of Direct Lending, given default rates, growth in the program, repayments, and the "profit" from repayments, the National Debt will increase by $348 billion between FY95 and FY2014.

Mr. Chairman, the enactment of the direct loan program effectively precluded exploration of innovations in the private sector-based program that may very well equal or surpass the ease in access to funds that many schools in direct government loans find so attractive. I understand that notwithstanding the fact that the Congress and Department of Education have not required or even encouraged program improvements in Federal Family Education Loans (FFEL), that the student loan industry is unilaterally undertaking implementation of such improvements on its own. Two of the most promising innovations are the Educational Loan Management initiative and the National Student Loan Clearinghouse. I also understand that much of the work of the industry is taking place in spite of poor cooperation from the Department of Education.

It seems the Department is reluctant to cooperate with the private sector when it sees itself as a direct competitor. I was very disturbed to see a quote from Mr. Leo Kornfeld of the Department of Education in a May 22nd Forbes article where he states, "I want to go toe-to-toe against the industry." This is clearly inappropriate and reflects the belief of some at the Department that the private sector is the enemy.

Mr. Chairman, I would respectfully suggest that this subcommittee pay careful attention to Mr. Kornfeld's activities in his capacity as Senior Advisor to the Secretary. A situation where the regulator of the private sector student lending sees itself as a competitor is most untenable.

There are several other observations I would like to make about the direct government loan program. These observations, among others, prompted me to introduce my bill:

First, I am concerned about how the Department of Education is marketing the program. Direct government lending is supposedly a break-through in administrative simplicity that all schools should be rushing to join. Instead, the Department is using part of the $2.5 billion made available for poorly defined "administration" of the program to **fund newspaper advertisements, to contract with a New York City advertising firm, and to send dozens of employees to financial aid conferences to sell the program. If direct government loans is so good, shouldn't the program be able to sell itself?**

In these times of serious budget problems, should the Department of Education be spending hundreds of thousands of dollars on advertising and public relations? I don't think so.

I would suggest, Mr. Chairman, that the administrative funds available for the direct government loan program have been subject to inadequate and deficient oversight at the Department. I urge your subcommittee to fully review the types of activities the Department is undertaking with monies that were understood by many of us to have been made available solely to service student loans.

Second, I am concerned about the types of schools that seem anxious to get into direct loans. Mr. Gordon has documented the disproportionate number of high-default schools that have applied for, or been accepted into the program.

What does the fact that problem schools seem to like direct government loans so much tell us? It tells us that the program appears an easy to source of virtually unlimited federal funds to these schools. It tells me that the direct government loan program is a disaster waiting to happen. Remember that the Savings and Loan debacle was about $50 billion.

Third, I am very concerned about the level of responsibility placed in the Department of Education. The Department of Education has a record of administrative inefficiency. As you know, it was the Department of Education that ran the Federal Insured Student Loan Program, the failed program that led to the concept of a decentralized, private sector based student loan program.

I simply do not believe that the management problems at the Department have disappeared, notwithstanding the fact that the 520 new bureaucrats being hired to run direct government loans, in direct contradiction of the premises of reinventing government.

I see no evidence whatsoever that the Department is doing a better job in policing the types of schools that get into the federal student aid programs. In fact, Mr. Chairman, the only real progress in reducing defaults resulted from imposition of cut-offs of schools for high default rates, something that Congress enacted on its own.

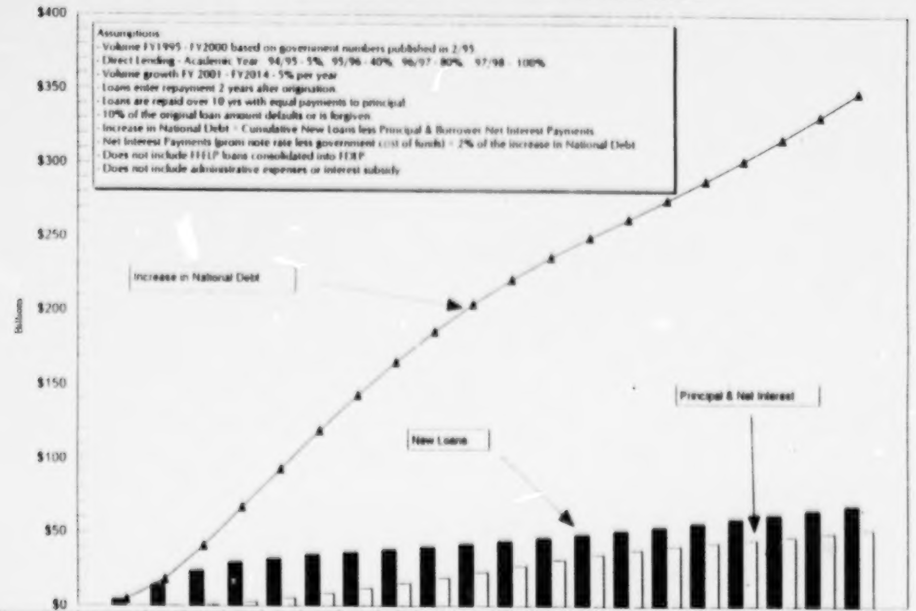
It is time for us to admit the mistake of enacting direct loans in 1993 and to get on with the project of making sure the private sector loan program works efficiently. The longer we delay getting rid of this ill-conceived government monopoly, the greater the problem will be in getting rid of it later.

I would like to close my statement by emphasizing that my reasons for objecting to the direct government loan program are reasons which appear to have strong bipartisan support.

On January 19, 1995, the President stood with the Vice President and several members of the Cabinet at the White House and said to the American people "We propose to stop doing things that government doesn't do very well and that don't need to be done by government." The Vice President went further. He declared to the American people who sent a clear mandate in November to reduce government that "over the next several months, we will be looking at every other agency and program asking the direct question, do we really need this agency; do we really need this program; there is a better way to do it; is there an opportunity here to give middle-class Americans a break? We have already eliminated over 100 programs. We will eliminate a lot more in the weeks and months ahead." Mr. Chairman, I urge all of my colleagues, Republicans and Democrats alike, to join in my efforts to help the President achieve these stated goals by supporting H.R. 1501 to eliminate direct government student loans.

I would be pleased to respond to any questions that you or any other member of the Committee may have.

Direct Lending's Impact on National Debt



Federal Fiscal Year	95	96	97	98	99	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
▮ New Loans Made	4	14	23	29	31	34	36	38	40	42	44	46	48	50	53	56	58	61	64	68
▯ Principal & Net Interest Pmt	0	0	1	3	5	9	12	15	19	23	27	31	35	38	40	42	45	47	49	52
▲ Increase in National Debt	4	18	41	67	93	118	143	165	185	204	221	236	249	262	275	288	302	316	332	348

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Chairman **HOEKSTRA**. Senator Simon, welcome.

STATEMENT OF SENATOR PAUL SIMON, A SENATOR IN CONGRESS FROM THE STATE OF ILLINOIS

Senator **SIMON**. Thank you. It's good to be back in my old haunts here. I spent 10 years as a Member of this committee, and it is good to be back here again.

I hope you will forgive me if I testify, and I would be happy to answer any questions, but I am going to have to leave right after I testify here.

First of all, I want to give credit to my House colleague, Tom Petri, for being the originator of this idea. I wasn't convinced for a while, and I remember picking up the Congressional Record and reading Tom Petri's statement and writing a note to Bob Sharman of my staff, "let's check into this."

Then I talked to Dave Durenberger, my colleague then from Minnesota, and we introduced a somewhat modified Petri bill over in the Senate, and Bill Ford on this side was very helpful in this whole process. This is a bipartisan thing.

Now I have to say, I don't quite recognize the reality from hearing my colleague from Oklahoma testify here. I don't know what happened in the House, but we sure had hearings over in the Senate, and I can remember those full page ads by Sallie Mae attacking the program. If it was hidden, they sure tried to un-hide it. They hired eight different lobbying firms here in Washington, DC to work on it.

You know, it was an uphill fight to get this passed, and it's interesting what's happened. Five percent of the schools now have it. Ninety-two percent of those give it high marks. All of the schools recommend that it should be universally adopted.

Now let's listen to testimony by Earl Dowling, Financial Aid Director at Iowa State University: Student employment down 30 percent in their office; two professional counselors have been reassigned to student support service; telephone traffic down 40 percent; long distance telephone costs decreased significantly; eight computer terminals were removed from operation at a cost savings of $200 per month—each per month, $1,600 a month savings on computers plus the personnel costs.

University of Illinois tells the same story. the other schools tell the same story. Community colleges took a look at it, and gave it high marks. Now what is not the case is that we're talking about the public sector versus the private sector. These are both public sector factors.

There is no guaranty agency that has any private money. It's Federal money. The question is whether we write a check or whether we hand somebody a checkbook, and the experience is, if we write a check and keep controls, it is much better for the students. It's much better for everyone except the people who make money on the present system.

Now the banks like the present system. They make more money on the average on a student loan than they do on a house mortgage or a car loan, and they get 100 percent guarantees. We have socialized profits in that area. Personally, I'm against socialism. I don't know what this committee feels about that, but I think we ought to take a look at this and look at the reality.

Now in terms of what my friend from Oklahoma says, the imbalance in how we assign interest, there is an imbalance, but it's the other way around. We assign to direct loans the 10-year costs, and we assign the short term loans costs to the guaranty agencies.

When he says he is for competition, I am also for competition. I am not for the Clinton Administration saying let's go 100 percent, but I am opposed to capping it at 40 percent. If the guaranty agencies and Sallie Mae and the others can do a better job for the schools of Oklahoma, let them do it, but don't say to the schools in Oklahoma or Ohio or Rhode Island or Indiana or North Carolina or any other State, you can't get into the direct lending program which these schools want to get into.

The Inspector General for the Department of Education testified about the conflicts of interest. With that Federal money that we have given to these guaranty agencies, some of them have created for profit entities, and guess what? They had the same boards of directors, and they make contracts one with another.

When I asked the Inspector General—I said, how much money is at risk for the Federal Government. He said, well, we have looked at 68 percent of the loans out there through the agencies, and in that 68 percent, we have $11 billion of Federal money at risk. That's a lot of money. That's our money. That's taxpayers' money at those guaranty agencies.

These guaranty agencies didn't issue any stock. No, that's our money. We ought to see that it is run well.

The General Accounting Office has concluded that the present student loan program, other than direct loan—its program structure is not conducive to good financial management and that traditional business incentives do not govern the Education Department's relationship with guaranty agencies.

Again, let me quote from a memorandum from the Department of Education under George Bush. This is not Bill Clinton now. "The current GSL system is error prone and extremely difficult to monitor and audit. Recent fraud and abuse scandals involving lenders and servicing contractors are only the latest in a long history of such scandals which State-level guarantee agencies have been unable to prevent.

"A direct loan program would be easier to manage and would greatly reduce opportunities for error and abuse. A centralized data base would improve data integrity and auditability. Department monitoring could be focused entirely on the postsecondary institutions and the collection contractors."

The reality is the present system encourages defaults. The direct lending program does not. In addition to the savings that we make in direct lending, because we're not giving this subsidy out there, you will greatly reduce defaults in the long term.

I favor, along with Tom Petri, giving this to IRS. I think they're a pretty good collection agency, an the IRS Commissioner has told me she's willing to do it.

I think that's really the way to go, and then we charge students a little above the T-bill rate, a little better than 2 percent, I believe, above the T-bill rate. That takes care of somebody who dies or is disabled or becomes a nun or, for one reason or another, doesn't have any income.

So I think the direct lending, by any rational analysis, is the direction we ought to go, not to mandate it for everybody, but don't put a cap on it. If Notre Dame University—and I, frankly, don't remember whether Notre Dame has direct lending or not, but if Notre Dame wants to go to direct lending, let them go.

I remember the president of Notre Dame testifying in behalf of direct lending, but if they want to go with a guaranty agency or private sector or a bank or Sallie Mae, let them do that.

If you're talking about the students, if you're talking about the taxpayers, if you're talking about the colleges and universities, direct lending is the way to go. If we're talking about profits for banks and guaranty agencies, by all means, limit direct lending.

I'd be happy to answer any questions.

[The prepared statement of Senator Simon follows.]

Statement of Senator Paul Simon
before the
Oversight Subcommittee
of the
Economic and Educational Opportunities Committee
U.S. House of Representatives
on the
Federal Student Loan Programs

May 23, 1995

Mr. Chairman, thank you for inviting me to testify on the Education Department's student loan programs. My colleague, Mr. Petri, is the real pioneer in the field of direct, income-contingent student loans. In 1991, David Durenberger and I latched onto the Petri approach and advocated it during the reauthorization of the Higher Education Act. At the time, we proposed that the billions of dollars in savings be redirected to the Pell Grant program, a critical funding need that continues to be neglected.

As a supporter of direct lending, I am pleased that the start-up of the direct loan program has gone remarkably well. Over the years, financial aid officers have been the victims of enormous micro-managing by Congress and the Education Department. As a result, they are, with reason, a skeptical group. Contrary to the doomsday predictions that school officials were hearing from lenders and guaranty agency officials, direct lending has been an unparalleled success. Indeed, it has been so successful that even the most minor of glitches gets attention in the education press.

Colleges large and small, public and private, are praising direct lending for the ease of administration. At a Senate hearing on March 30, Earl Dowling, financial aid director at Iowa State University, testified that direct lending allowed for "the best fall opening ever" on his campus, while it required fewer university resources:

- "Work-Study employment in our office has been reduced by 30 percent."
- "[T]wo professional counselors have been reassigned to student support service."
- "Telephone traffic...was down 40 percent...compared to the same time period under FFELP."

- "[L]ong distance telephone costs decreased significantly."
- "[E]ight computer terminals were removed from operation, at a cost savings of $200 each per month."

In a survey conducted by Student Aid News, 92 percent of direct loan schools gave the program a high ranking, and *all* would recommend it to other schools. Likewise, a survey of community colleges in the program, conducted by the Association of Community College Trustees, found a very positive response. For example:

- "It is simple, quick, and less confusing."
- "This is the first time in my experience that a program was started where institutions could select how they participated and really had institutional flexibility and control."
- "This has been the freshest breath of air in a long time."

But the best people to talk about how direct lending is working at the school level are the financial aid officers, students, and families who are participating. My testimony, therefore, will focus on the questions that the federal government should ask about the Federal Direct Student Loan Program (FDSLP, or the direct loan program) and the Federal Family Education Loan Program (FFELP, or the guarantee program).

FFELP: FUNDAMENTALLY FLAWED?

Opponents of direct lending are fond of calling it the Direct GOVERNMENT Loan Program. Make no mistake about it, both direct lending and FFELP are government programs, and each would involve about the same number of Federal employees. (This does not count the thousands of Federally-funded state government employees working at guaranty agencies in FFEL). The question is, which is the better way to run a Federally-backed student loan program?

Now that direct lending is such a success at the school level, some are arguing that the program will somehow increase defaults, or that we won't know whether direct lending works until years and years of collections have occurred. That is preposterous. School eligibility is the same in either FDSLP or FFELP. The Education Department and accrediting agencies have improved their oversight of schools, and more needs to be done. But one need only look at the structure of the two programs to reach a conclusion about loan collection:

WHICH LOAN IS MORE LIKELY TO BE COLLECTED?

FFEL Program	Direct Loan Program
Collected by private contractors or lenders -- or by a federally-backed guarantor with a conflict of interest.	Collected by experienced private contractors that will lose their contracts if their collection efforts are insufficient.
Lender gets repaid 98 to 100 percent even if the borrower defaults.	
Guaranty agency (first backstop responsible for preventing and collecting defaults) has a financial incentive to ***allow*** defaults.	

The guarantee approach is very complicated, but the essential difference is that in the direct loan program, the government writes the checks; in FFEL, we give the checkbook to guaranty agencies, and they write checks on the Federal government's account. The key question is, when they are spending billions of dollars that isn't theirs, and collecting on loans that are ultimately backed by the Federal Government, do they act responsibly? If you ask the auditors, the answer is a resounding "no":

Inspector General. At the March 30 hearing, I asked Steven McNamara, Assistant Inspector General for Audit, about a recent audit of the Texas guarantor that found **$178 million in liabilities**, caused by a conflict of interest. McNamara explained:

> "[T]he general counsel and the agency had entered into a contract on the general counsel's firm's letterhead, a one-page contract, which did not go into any great length on the due diligence procedures that should have been followed in attempting to collect on defaulted loans referred from the guaranty agency.
>
> "As a result of our review and our sampling of the records, we concluded that the general counsel and litigation contractor had not taken the necessary due diligence actions to follow up and help assure collection on defaulted loans, and we recommended the recovery of $178 million."

I then asked him whether these kinds of conflicts of interest are an isolated problem. He responded that at least **$11 billion is at risk**:

> "We did an audit...where we looked at 12 guaranty agencies that accounted for close to $60 billion -- I think it was about 68 percent of the loan portfolio in total. And of those 12 that we looked at, nine of them, or about $40 billion, had relationships with servicers, secondary markets, and other FFELP providers, where they were either a parent and had spun off subsidiaries that they had a financial interest in, or perhaps there were members of divisions in a large corporation. In any event, what we concluded was that this put the guaranty agency in a conflict situation in enforcing due diligence and other requirements against entities that it had a financial interest in. We felt that this could put the accuracy of the data at risk if they were supposed to go in and take a look to make sure that all the due diligence information was provided in a timely manner, say, by a servicer that they owned; if it was not, they would be at cross-purposes if they took action...
>
> "In our report, I think we said that of the nine guaranty agencies we found [conflicts of interest] to be the case in, we figured about $11 billion was at risk."

In further questioning, Senator Coats asked whether these conflicts would also exist in the direct loan program. Mr. McNamara responded that they would not:

> "The guaranty agencies have spun off or entered into arrangements with other subsidiaries or profit-making corporations. We would not have that under direct lending. The Federal Government would be making the loans directly. You would not have the guaranty agencies there, so it is a different situation. **You would not have the conflict.**"

General Accounting Office. The U.S. General Accounting Office has concluded that the student loan "program's structure is not conducive to good financial management" and that "traditional business incentives do not govern [the Education Department's] relationship with guaranty agencies." Furthermore, it is difficult to penalize agencies for improper spending or activities because "penalties can weaken the financial condition of the guaranty agencies and result in Education penalizing itself instead of the agencies." GAO cites an example of an agency that owed the Department $25 million in penalties, but the Department did not press the issue. Why? Since "the Department is ultimately responsible for all default claims, it would then have to provide the guaranty emergency advances to enable it to continue paying lenders for defaults."

GAO also points out that because guarantors make extra money when they collect defaulted loans, the agencies "have more financial incentive to expend resources collecting defaulted loans than working with borrowers to prevent defaults."

Mr. Chairman, this is just the beginning. A June 1994 audit by GAO found that we do not really know how much the FFEL program costs, and that we may be losing money by overpaying lenders. These problems:

> "were caused largely by the structure of this program, which sometimes limits Education's practical ability to require guaranty agencies to correct the student loan data errors that they have submitted."

The Bush Administration. President Bush's Department of Education seriously considered promoting direct lending. In a February 21, 1991, internal document, preventing abuses was a primary factor:

> "[T]he current GSL system is error prone and extremely difficult to monitor and audit."
>
> "Recent fraud and abuse scandals involving lenders and servicing contractors (e.g., Florida Federal, FITCO, UES/Bank of America) are only the latest in a long history of such scandals which State-level guarantee agencies have been unable to prevent."
>
> "A Direct Loan program would be easier to manage and would greatly reduce opportunities for error and abuse. A centralized data base would improve data integrity and auditability. Department monitoring could be focused entirely on the postsecondary institutions and the collection contractors."

Minneapolis Star-Tribune

An April 24 expose reveals how officials at the Northstar Guarantee Agency set up a for-profit corporation, owned by the agency officials, to do the work of the agency. This is a clear conflict of interest, violating Better Business Bureau guidelines for non-profit organizations.

The reporter also reminds us, in a sidebar titled, "HEAF cost taxpayers $280 million," that the previous Minnesota agency, the Higher Education Assistance Foundation, collapsed a few years ago, in part due to conflicts of interest.

Chronicle of Higher Education

In its May 19 issue, the Chronicle reveals problems at a number of agencies. The most flagrant abuse was at the South Dakota agency, where agency officials bought a building from themselves and contracted with their own company on the side. But the most serious abuse was at a much larger agency, American Student Assistance. This Massachusetts-based agency over-charged the government by setting up a separate corporation and charging themselves a 10 percent mark-up.

COST SAVINGS: WHAT ABOUT THE CRS STUDY? WHAT ABOUT ADMINISTRATIVE COSTS

Opponents of direct lending are now brandishing a memorandum by one division of the Congressional Research Service that purports to show that direct lending does not save money. They fail to mention that the authors' conclusion is based on one very big "if": **the conclusion applies only IF** the guarantee program does not have any excess profit, or other waste and abuse. That is a very big "if." (As I have just detailed, there is clearly waste and abuse in the FFEL Program, so the CRS memo is only a theoretical discussion about a guarantee program that does not exist.)

Opponents also have made a lot of noise recently over the fact that the Budget Act scores direct loan administrative costs on a cash basis, rather than an accrual basis. But they fail to mention other shortcomings of Credit Reform that work against direct lending. These other problems more than offset any advantage that the administrative costs problem supposedly gives to direct lending:

Cost of Funds. The most significant item that overstates the cost of direct lending is the discount rate that is currently used. The interest rates that students pay vary annually, and the subsidized rates that the federal government promises to banks vary each quarter. A Council of Economic Advisors memorandum of April 30, 1993, points out that "a multiple year loan with an interest rate that resets each year should be treated for pricing purposes as having a maturity of one year," meaning that a short-term rate should be used. But CBO and OMB assume that the government's cost-of-funds is a higher, long-term rate, the 10-year bond. This makes direct lending appear much more costly than it really is. Indeed, in a February 8, 1993, letter -- which pre-dated the Student Loan Reform Act, so the estimates would be different now -- GAO points out that using shorter-term interest rates would increase direct loan savings from $4.7 billion to about $11 billion over five years. (Long-term administrative costs were already included in the GAO estimates).

Tax-exempt Bonds. Testifying before the subcommittee today is a representative from one of the tax-exempt secondary markets. This tax exemption costs an estimated $2.3 billion over five years, a cost that is not considered when the Congressional Budget Office determines how much direct lending saves.

Taxpayer Bailouts. When guaranty agencies agree to "share" the risks under FFEL by paying a larger portion on defaulted loans, they are using money that belongs to the Federal government -- so we are essentially sharing with ourselves. Furthermore, when any agency can't pay its share, the Federal government steps in and bails them out. These costs aren't currently considered.

THE RIGHT INCENTIVES, TO BENEFIT TAXPAYERS, STUDENTS AND SCHOOLS

Mr. Chairman, as you can see from the independent audits, FFELP is mired conflicts of interest and perverse incentives, leading to waste and abuse. The direct loan program, in contrast, uses market forces and incentives to bring a more streamlined, more accountable, less expensive program to students, taxpayers and schools. Furthermore, direct lending allows for income-contingent repayment, which will be a great benefit to many borrowers.

As we struggle to bring the Federal budget into balance, we will face a stark choice: we can impose costs on students, or we can adopt a system that eliminates the excess profits, waste and abuse.

Thank you for the opportunity to testify.

Chairman HOEKSTRA. I will pass on any questions. Does anybody have any questions for the Senator?

Senator SIMON. A former Illinois resident, I want you to know.

Mr. CUNNINGHAM. And coach. Good to see you again, Senator. I'm against the direct loan system, but I also want to know how Mr. Petri and yourself—If we go to a flat tax, how will that affect the collection?

I at one time wanted IRS to do it also, but I know there are several things before the House and the Senate to look at a different system, and how would you collect those fees?

Senator SIMON. The answer is, under the present system you can go to income contingent or you can have a direct amount taken out each month. When you get into the intricacies of computers and so forth, I'm not the person to answer the question, but the IRS people tell me they can do it.

Mr. CUNNINGHAM. I'm under a personal belief that the government does things less efficiently than private enterprise.

Senator SIMON. Generally, that is true. For collections, IRS is pretty good, I have to say.

Mr. CUNNINGHAM. Well, unfortunately, we don't like those rascals, but I look at—You know, we're providing Federal student loans. That comes—It's not free money. We have to tax people to take it out of their pockets to turn around and give it back and feed a bureaucracy at the same time. So we don't get the percentage of dollars back down to the students as we do in the direct.

Then the President's got his AmeriCorps where a student can earn up to $30,000 a year. So we're also financing that student's repaying it involuntarily. I look at the overall system on the interest on the debt that we accrue, and I know the GAO and CRS have not come up with actual figures on the actual cost.

If you have this where it's income contingent, and the average, CRS says, is about 14 years, interest rates go up a lot over that period of time. I know that we need accurate figures before, I think, we can make a decision on things, and I think that's why a pilot program with a cap, before we jump headlong into this thing, would be much more efficient. If you could comment, Senator.

Senator SIMON. Yes. Well, that's why we started with a 5 percent. We're at 40 percent this fall, and we can gradually grow, but again I'm not for mandating all colleges and universities go into the direct lending program. If the others can compete and do a better job, they should do it.

In terms of your earlier remarks, AmeriCorps reaches only a percentage of the students, and in terms of tax money that goes into this, that is true, but that's also true for our grade schools, our high schools, and we have learned that education really does pay off.

Mr. CUNNINGHAM. I don't disagree with that. I just think there's a better way to do it, Senator.

Senator SIMON. Well, we ought to do it the best way we can. There's no question about that, but it is interesting—I'm old enough to remember after World War II. We thought we would give a gift to veterans, the G.I. Bill, and we made a grant to veterans.

It turned out to be not only a gift to veterans, but a huge investment in our own prosperity. If you take that old G.I. Bill, the average payment, and put an inflation index on it, today that would be averaging a grant of $9,400.

Now I like to believe I'm a brave Senator, but I'm not going to advocate that we have $9,400 per student grant. You know, I wish we were in the financial situation to do that. I think it would be a great investment in the future of our country.

I think we have to find the most efficient way of doing it within the resources we have, and I think that is the direct lending system.

I thank you, Mr. Chairman and Members of the committee.

Chairman HOEKSTRA. Mr. Istook, you will get your turn. I think we have——

Mr. ISTOOK. I wanted to mention, Mr. Chairman, I need to leave for another meeting. If there's a time for me to respond on that IRS point, I'll do so. Otherwise, I'll talk to people privately, but I do need to get away for another meeting.

Chairman GOODLING. Mr. Chairman.

Chairman HOEKSTRA. Yes, Mr. Chairman.

Chairman GOODLING. Well, I just wanted to refer to a statement that the Senator made, that he wasn't sure he was for this, and that there weren't any Democrats for it when Mr. Petri was bringing it up. I'll guarantee him there were zero, and the amazing thing is that the very person for whom it is now named was one of the leading opponents to direct lending, and it wasn't until someone came up with some goofy idea that, if we score this in a goofy manner, we can say we get savings and, therefore, we can deal with the savings issue in our committee; because we were told to come up with a certain amount of savings.

Now we have no idea whether there any savings or not, but at least that's what they said. So I just wanted to make sure that you weren't along, because the former chairman was an outstanding opponent to the whole concept.

Senator SIMON. I was a skeptic, too. I also want to say to Bill Goodling——

Chairman GOODLING. But you won't know for seven years whether you were a good skeptic or a poor skeptic, because we won't know for seven or eight years or nine years unless we say to the colleges and universities, you collect; we'll give you a percentage over a certain point, but you collect these debts. Then we'll find out how many colleges and universities are interested in participating.

Senator SIMON. I tend to believe GAO and CBO. I might also add to my friend Bill Goodling, if he stays here long enough, he can move down the line in seniority here.

Chairman HOEKSTRA. He fills this Chair very nobly on those days when we have full committee meetings.

Chairman GOODLING. One other comment. I was going to say to the Senator before he leaves, in light of Senator Nunn's hearings last year, where it was revealed that schools were drawing down Pell grant funds for ineligible students time and time again, due to the Department's inability to account for funds, we'd better go slowly and make sure they can do a better job here than apparently, according to Senator Nunn's hearing, they did in relationship to Pell grants.

Senator **SIMON**. There is no question that they have not done a good job in the accrediting side here, and that's the real problem. I think there is fairly universal praise of the job they're doing now in terms of direct lending.

Chairman **GOODLING**. But they're only doing the lending right now. That's easy.

Chairman **HOEKSTRA**. There are a couple of people who have a couple more questions for you, if it would be all right, although I would like to let Mr. Istook respond to the IRS, and then we'll go to Mr. Sawyer.

Mr. **ISTOOK**. I thank you. I'll certainly try to be brief. Mr. Chairman, as a member of the Appropriations Committee, I serve on the subcommittee which has the Department of Education. I also serve on the subcommittee which has the Internal Revenue Service.

I think it is unrealistic, at best, to expect that the IRS would suddenly become an efficient collector of a large quantity of student loans under this program. Certainly, we have heard much testimony, for example, comparing the collection rate, the cost per collection of the IRS compared to private debt collection agencies, and suffice it to say that there are certainly problems there.

As far as the ability to handle the information, the IRS has been on a multi-year computerization project of the tax modernization system, which is years behind schedule and appears to be hundreds of millions of dollars over budget, and we, frankly wonder sometimes if it's going to be able to get that function taken care of.

I believe that—All I'm trying to say is I know they're working hard but, Mr. Chairman, to try to say that the IRS can solve the problems by being a very efficient collector of a student loan program, I think, is very unrealistic.

Senator **SIMON**. Let me just add, that is not essential to this. I happen to disagree with him, but at the present time the Department of Education plans to use private collectors on a competitive bid basis.

Chairman **HOEKSTRA**. Mr. Sawyer.

Mr. **SAWYER**. Thank you, Mr. Chairman. I just wanted to take a moment to thank the Senator for being with us today. It's been a pleasure to work with him in the past, and I look forward to working with him on this.

I have to agree with you that the opportunity that we have to observe and compare programs in a competitive environment of comparable loan volume is a rare and important opportunity that we shouldn't pass up.

I also wanted just to take a moment to assure myself that it was only in the narrowest possible terms that you were drawing an equation between being disabled, deceased or a nun. Thank you, Mr. Chairman.

Chairman **HOEKSTRA**. Mr. Roemer.

Senator **SIMON**. Let me thank my colleague for his leadership in the literacy area, which I really appreciate.

Mr. **ROEMER**. I don't have a question. I just have a very short statement to make about you, Senator Simon. I personally, and I think many Members of Congress, also will greatly miss as you retire from the Senate in 1996 your expertise on education issues, your devotion to improving education in the United States, and your tireless dedication to issues that affect children.

You are a valuable resource that the House and the Senate has gained a great deal from, and we will truly miss.

Mr. CUNNINGHAM. Would the gentleman yield?

Mr. ROEMER. I'd be happy to yield.

Mr. CUNNINGHAM. I'd like to second that, and I would also like to add to the gentleman's pride who take an active part in education, and I want to thank the Senator and associate myself with the remarks.

Senator SIMON. Thank you.

Chairman HOEKSTRA. Thank you, Senator.

Chairman HOEKSTRA. Thank you for being so patient. We'll turn to you now, Mr. Gordon.

STATEMENT OF HON. BART GORDON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. GORDON. Thank you, Mr. Chairman and committee Members. I think one thing that you're going to find here today for sure, and it is something that juries have known for a long time, and that's four honorable people can witness an accident, come before you, and tell a different story, thinking that they are telling the correct thing. So as members of the panel and members of the jury, you're going to have to weed through all that today, but I do thank you for giving me the opportunity to be here.

Let me just real quickly—and I don't want to try to rebut all that Senator Simon said. I do want to change the context one bit. First of all, you're here, certainly, to review the direct lending program. The second thing is, you're here reviewing Mr. Goodling as well as 70 other co-sponsors of a bill that we have—Mr. Goodling and I have—concerning testing the direct lending program before it's fully implemented.

Senator Simon characterized that as stopping schools like Notre Dame which, by the way, does not want to get into direct lending, from being able to get into the program. What we're trying to do is preserve the opportunity for schools to have a choice.

The Department of Education now wants to conscript, wants to force your schools, whether they like it or not, into the direct lending program, to take away the option. So our bill simply provides that option, to have a test, and then in two years the full committee will review and then make a determination of what should happen. So I just wanted to be sure that we had put it in the right context.

Education has been a high priority for me as well as trying to find ways to make loans more available for students during my time here in Congress, for the same reason that it's of concern to all of you. Constituents have come up to me and told me of the difficulty they are having with affording to send their kids to school now.

Again, Tennessee, I think, reflects the same thing all of you know. In the last 10 years the price of just public schools in Tennessee has gone up 123 percent. Yet the income in Tennessee has only gone up 89 percent. So I guess next to health care, probably higher education has gone up faster than any other commodity we have, and it's tough—tough—for kids.

Good gracious. I hope people like Mr. Istook—I don't know what in the world he's going to do, but if you just have one or two kids, you know how difficult it is. That's the reason all of us are looking for ways, honorably—We're looking for ways to make it more available.

That's what I was trying to do. You know, the old way: Let's just shovel some more money into the program. That doesn't work now, and we all know that. So I looked into the student loan program, and here's what I discovered.

In 1980 we had a $3 billion student loan program and a 10 percent default rate. In 1990 we had a $7 billion student loan program and a 54 percent default rate. We were spending more moneys on defaults 10 years later than we did on the whole program beforehand.

If we could get that default rate back to 10 percent, then we would have more than enough money for every student in America, regardless of their income, to be able to have a loan, as well as save money for the taxpayers. So the next question is how did we get in this shape?

So I kept looking. I looked further, and I found that in the early 1980s that proprietary schools, for profit schools, were allowed to come into the program. I think, you know, we would all agree that anyone who wants to go to Boston Plumbing Schools is just as honorable as going to Harvard, and so there's nothing wrong with proprietary schools, which oftentimes are trade schools.

As a matter of fact, many of them serve a good purpose, but what had happened, when they got into the student loan program, we found that there were many proprietary—you know, people making profits in these schools that were more interested in getting a student's money than giving them an education. So once they got into the program, you know, to heck if they showed up for any classes. You know, they weren't going to try to get them a job, because they'd already gotten their money.

Then, what we found was that students leaving these programs hadn't gotten the kind of training that was necessary. They couldn't get a job. They defaulted, and obviously, the taxpayer suffered, but also that student suffered; because once you default on a student loan, you can never get another one.

Oftentimes, they were sucked into these programs thinking they were going to try to improve their life, only to find another door slammed. So then I went undercover to make sure that this was the case.

I have a copy—NBC helped on that, and I have a copy of that. You can see for yourself when I went undercover to find out what was going on in these schools, and that's what they would say. Come on in; it's free money. You know, don't worry about it.

I guess that's the reason that I spent so much time working with Members of this committee to reform the student loan program, and we've put in a number of reforms, and the results are already showing. Last year, after the first year of the reforms, we saved $700 million by kicking out some of these high default schools. This year, it's $1.2 billion, and continuing to increase.

Because of that success—and I think that can be a model for— This is sort of collateral to all this, but as we start looking at cutting student loans and various things, we might look at making them more efficient rather than just cutting them. That's what we did with this program.

So we're saving $1.2 billion. So that is my big concern with the direct lending program. After making this success, making this a better program, the direct lending could undo all that success, because the direct lending program says, once you get into the program, your default rate doesn't matter any longer. It's a get-out-of-jail-free card.

You know, so what if you have a 90 percent default rate. You're in the program. You've got a blank check. They come in. You just write them. You know, we're going to undermine all the reforms, all the savings, and also really the protections for students to know they're getting in a school that can give them a good education. That concerns me.

I'm not alone in this. The Advisory Committee on Student Financial Assistance, which was set up by the bill to overview the direct lending, just in their first review of it, point out there are some good things about direct lending, but they also make it very clear, in their words, that direct lending—or allowing schools in with questionable records.

I want to make this a part of the record. I also want to make a part of the record an evaluation of that that Mr. McIntosh, Peterson and Pomeroy and I have that shows just how bad it is to let these schools into direct lending, and I make that a part of the record also.

Also, Senator Simon mentioned the savings, the cost savings of direct lending. Again, this is illusory? I want to make a part of the record a report from the CRS too.

Let me just very quickly read something to you so that we can in real world dollars know that there are no savings here, and we need to look at other areas. Here is what they say: "What started this search for reform of the loan program was exploding default rates and more than competitive returns for commercial lenders. The proposed solution, direct lending, is largely irrelevant as a means of reducing these costs. More than competitive returns were virtually eliminated by the 1993 Student Loan Reform Act and, if anything, direct loans may increase default rates. There may be a logical rationale for direct lending, but lower cost is not it."

So we'll get that off the table and try to talk about some other of the gentleman's concerns there. Finally, my last exhibit is 50 letters from 50 colleges across this country asking you not to force them into direct lending, not to allow Department of Education to use conscription, saying please test this program first.

I want to make these a part of the record, as well as a letter from Secretary Reilly, whom I admire very much, who makes it clear that the Department is going to conscript schools in your district and in my district, whether they like it or not, to meet their goals of going to full direct lending. I want to make that a part of the record.

So once again, you know, you've got schools like Duke, Penn State, Northwestern, Notre Dame, Vanderbilt, University of South

Carolina saying the same thing that Bill Goodling and I are saying. Give it a chance. Let's see if this program is going to work. Then, in two years, you'll have a chance to make a determination when you get ready to reauthorize.

Let me tell you what we know now. Direct lending, although they want to go to 100 percent—Direct lending has been in existence for one year. What do we know? Well, we know this, that over that one-year period they can loan out $800 million, but they've collected less than $1 million.

For goodness sakes, let's test this program first, because what we've got here is a situation where direct lending is going to, over the 25-year period, require $400 billion in additional Federal debt. It's going to require hiring hundreds of new Federal employees and thousands of additional contract employees without any additional savings, and without any appreciable benefits for the student.

So why in the world are we going to take on this kind of risk unless not just that direct lending is just as good, not just that direct lending is maybe a little bit better, but that it's substantially better, and you can't know that without a test. What our bill simply does is set up a test and then, in two years, when you reauthorize, evaluate it. You can say let's go to 100 percent direct lending, let's do away with it, or let's have a combination.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Gordon follows:]

STATEMENT OF HON. BART GORDON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. Chairman, I want to thank you and the committee for extending to me the invitation to appear before you today.

As you may know, for several years reform of Federal student loan and grant programs has been one of the top priorities of my service in Congress.

My strong interest in this issue began when I was approached by middle-class parents in my district who complained that the cost of college combined with the difficulty in receiving financial assistance meant that their children were putting off college for a year or two—or sometimes forever.

I decided to take a hard look at exactly where the billions of tax dollars for grants and loans were going.

I found that in 1980, about 10 percent of new funds appropriated for loan programs went to pay-off bad or defaulted loans, but by 1990 54 percent of those funds were going to cover defaulted student loans—and not available to other worthy students.

My investigation of this default explosion led me to the source of much of the problem, unscrupulous proprietary schools which were not in business to educate students but instead to use students to get access to Federal dollars.

The bad apples have been very bad for Federal loan programs.

For the record, I would like to submit to the committee a videotape of the NBC news program, *Expose* which includes my own videotaped undercover visit to one Tennessee proprietary school and gives an accurate overview of how problem schools have wasted precious funds in both the Pell grant and student loan programs.

After two years of a very hard fight, we enacted real reform and I am proud to report that default rates are decreasing.

This is especially relevant today because my strong preference for a thorough and fair test of direct lending before full implementation is based, first and foremost, on my concern that the worst of proprietary schools will flourish in the direct loan program.

Others, including the Advisory Committee on Student Financial Assistance [the group responsible for reporting to Congress on the status of Federal student assistance programs] have reviewed the direct loan program and share my concern.

I would like to submit a copy of a report written by the Advisory Committee on Student Financial Assistance in the form of a letter to Senator James Jeffords. While acknowledging some positive aspects of the new loan delivery system, the Advisory Committee finds that the Department of Education is allowing schools with "questionable records" into the direct loan program unnecessarily risking serious program integrity problems.

As this report indicates the direct loan program currently does not figure default rates for participating schools and allows schools to draw down Federal funds directly.

With the Advisory Committee report, I will include the analysis of this problem as presented by Representatives McIntosh, Peterson, Pomeroy and myself in a press conference last month.

The Department of Education has contested the points we made last month as well as the findings of the Advisory Committee, but I believe the concerns raised in both cases are accurate. Institutions like the Las Vegas School of Gaming with a 47 percent default rate—and dozens others like it—do not belong in any loan program and certainly should not have been allowed into direct loan program where default rates are not calculated.

I also want to address the fact that this debate had been confused by claims that the new program will mean billions in real tax dollar savings. On March 10 of this year I asked the Congressional Research Service for a straightforward, non-partisan account of the budget savings potential of the direct loan program. That is exactly what I received.

I would like to quote from the summary section of the analysis:

> "What started this search for reform of the loan program was exploding default rates and more-than-competitive returns for commercial lenders. The proposed solution—direct lending—is largely irrelevant as a means of reducing these costs. More-than-competitive returns were virtually eliminated by the SLRA [1993 Student Loan Reform Act] and, if anything, direct loans may increase default costs ... There may be a logical rationale for direct lending, but lower cost is not it."

Mr. Chairman, I submit this CRS analysis as a part of my testimony and hope that each Member will give it a careful review because this non-partisan document refutes the saving claim which has been the driving force behind direct lending.

As my final submission today, I will provide to the committee copies of 51 letters—50 letters I received from schools all across the country and one letter from the Department of Education. These letters express a common concern about direct lending and a shared desire to see the new program thoroughly tested.

Unfortunately, this letter from the Department of Education confirms, I believe for the first time, that the Department is planning to use its conscription powers to force schools like these into direct lending against their wishes.

I believe schools like Duke, Penn State, Northwestern, Notre Dame, Vanderbilt, and the University of South Carolina know more about what is in the best interest of their students than anyone in Congress or at the Department.

I have found that most Members of Congress and the vast majority of schools do not realize that the Department of Education is poised to use conscription powers to add loan volume to the direct lending program.

I believe the Advisory Committee report, the CRS budget savings analysis, these letters from schools and confirmation of the Department's intent to conscript point us toward a test-first approach to direct lending. That is the goal of our bill, the Student Loan Evaluation and Stabilization Act of 1995.

H.R. 530, the legislation which I am co-sponsoring with Chairman Goodling will:

[1] improve Congressional oversight of the billions of dollars the Department of Education spends to administer this new program

[2] requires that the Department of Education track loan defaults at direct lending schools

[3] ensure that loan guaranty agencies are not forced into insolvency, contrary to Congressional intent

[4] provide that administrative costs are scored the same way for the direct loan program and the public-private guarantee program, and

[5] limit the proportion of student loans made through direct lending to 40 percent of new loan volume [the level set aside for the 1995–1996 academic year].

Mr. Chairman, in closing I would ask that we all think carefully before moving to direct lending.

I believe the case for 100 percent direct lending must be very compelling to justify $400 billion in added and unnecessary Federal borrowing, no savings in real tax dollars, hundreds more bureaucrats at the Department of Education, a new set of servicers, and if the Department is willing to approve guaranteed program improvements, no significant advantage for schools or students.

The new program has loaned over $800 million so far and collected less than one million. We know the Federal Government is better at loaning than collecting. We need a real test.

I hope both proponents of 100 percent direct lending and those advocating complete repeal consider H.R. 530 an opportunity to win this debate in the right way. If FDSL really works—with no serious default, management, or servicing problems—our bill will prove just that and we can forward to 100 percent loan volume.

If, on the other hand, problems with direct lending prove too numerous and too serious to justify what the program adds to the national debt and Federal bureaucracy, we know before dismantling the guaranteed loan program.

To both sides of this debate, I say "don't be afraid of a fair test"—it's the right thing to do for taxpayers, schools and most of all, students.

Chairman HOEKSTRA. I've just got one question for you. If we—I'm predisposed to your position, but if we wait two years, which means we'll have three years of loan experience under our belt, do you really think we'll have the information necessary to decide whether we are a good collection agency or in the long run would be a good collection agency?

Mr. GORDON. Well, I trust the committee to make that determination. In two years you may or may not have that information. If you do, you should make a decision. If you don't feel comfortable with it, then this committee can authorize it for one more year, for two more years or whatever you think; but I think, again, I trust the committee to make that determination.

Whatever it is, I'm sure there is going to be some fine tuning, but we simply need more experience, more information before I think you can make that valid determination.

Chairman HOEKSTRA. The concern continues about having two duplicative programs, the prior system and now direct lending, and running both programs simultaneously. I just wondered whether you had some insights into why you thought two years would be appropriate and why we would have the information in two rather than in four or five.

Mr. GORDON. Well, two years is when the higher education bill will come up, and you will be reauthorizing. So, I mean, that's the natural sort of demarcation line. Again, if you want to push that back, you can.

You raise a very good question about a dual system. You know, it may be heresy, but let me just give you some of my quick thoughts. We're not going to have two systems unless our bill goes into place. The administration and the Department of Education will go forward with full direct lending. They will undermine the private sector, and it will be gone. You can't put it back together. Humpty Dumpty will have fallen off.

I talk to an awful lot of schools. I mean, there are going to be few people that have talked to more schools about this program than I have and, honestly, I'll tell you what I'm finding. There are a variety of schools that like direct lending and want to keep it. There are just as many schools like Notre Dame and Vanderbilt and University of South Carolina that don't want it, and both those positions are in the minority.

The vast, vast majority of schools say, you know, I don't mind it being tested. I don't mind somebody else having a chance to use it. I don't mind—You know, we may want to use it sometime, but test it, you know.

One thing that the 80–90 percent of schools will agree upon is they don't want to be conscripted. They don't want to be forced into the direct lend program, and that's what will happen.

What I'm seeing right now is in the short term, having both systems is good, because it is pushing both the private sector and Department of Education to do their best. They're out there competing to make it a better system for the schools as well as for the students, and that's healthy, and we would have a better program because of that competition.

Now one of the problems you have is that one of the competitors is also the regulator, and so, you know, it's hard—You know, if you were playing basketball, you wouldn't want, you know, your opposing team to also be the referees, and that's what we have now with Department of Education being both the regulator as well as the competitor.

Part of our bill tries to, as best we can, level that playing field. The other option: You may decide a dual system may be best in the long run.

Chairman HOEKSTRA. Mr. Sawyer.

Mr. SAWYER. Thank you very much, Mr. Chairman. Bart, you've done just a remarkable job on this. You've been tenacious and gone into great depth throughout the entire time that you've been working on this, and I have to admit that there is absolutely nobody who has put in more time. I certainly can't imagine that there is anybody who has talked to more schools than you have.

Let me comment just briefly. It seems to me that the comparison that you made between the default rates in 1980 and those 10 years later may have been a little bit misleading, in that the default rate of 10 percent remained essentially stable throughout that decade, but that the cumulative relationship between debt volume and currently outstanding debt had risen to 54 percent, but that's not the same as a 10 percent annual default rate. Would you concur with that?

Mr. GORDON. Well, of course, you could say the same thing for the prior 20 years, before 1980, and you didn't see that kind of dramatic increase then.

Mr. SAWYER. Of course, you could. Of course, you could, and there is no question but that the kinds of reforms that you've been advocating——

Mr. GORDON. And you're a part of it, too. All of us were a part——

Mr. SAWYER. We have all worked toward that.

Mr. GORDON. [continuing] of helping reduce that default rate.

Mr. SAWYER. I agree with that. I would also like to suggest that the current lending in the direct lending program, the collection rate—it probably is a little premature to be comparing $1 million to $800 million.

Mr. GORDON. Oh, sure. It's premature to be comparing it, and it's certainly premature to be saying go to 100 percent, start conscripting schools all over the country.

Mr. SAWYER. I understand that. You're looking for a competitive environment. Can I assume then that you wouldn't want to see anybody forced to that 100 percent nor would you like to see it capped at 40 percent, for example, so that those schools out there that might want to make a decision would be precluded from making that kind of decision?

Mr. **GORDON**. I think that's what our bill does, because the Department of Education, and we have it in writing, has made it clear. They want to move beyond—They want to go to 100 percent direct lending, and once that occurs, then you undermine—and they would like to do it tomorrow, if they could—you undermine the infrastructure within the private sector.

So they're trying to take away the right of schools by conscription to have a choice. So what our bill does—It just puts into place, really, a holding pattern. I think the Department is at 29 percent right now. So it still gives them plenty of room. They want to go on up to 40, until you have a chance in two years to review this.

If we don't do that, then they are going to take away that option, because they're going to take it to 100 percent direct lending.

Mr. **SAWYER**. It seems to me, Bart, that caps are as much a detriment to an open, competitive environment as conscription is. So——

Mr. **GORDON**. I think the difference, though, the cap is for two years. The move to 100 percent direct lending and conscription of schools is forever.

Mr. **SAWYER**. That may well be, but that doesn't provide for a competitive environment, if we're really looking for schools to have the opportunity to make choices based on that comparative advantage from one system to another.

Mr. **GORDON**. Okay. Well, then let's do this, Tom. If that's the case, then can you get the Department of Education to say they won't conscript schools, because it's not voluntary if you're made to get into the program, and the Department of Education, within writing which I've submitted to you, says they are going to conscript.

That's part of what our bill says. It makes clear, they can't conscript. They can't force schools in.

Mr. **SAWYER**. I hear you clearly, and I'm just saying that if I'm going to do that sort of thing, then it makes little sense to have a limitation on the kinds of choices that a school could make in moving back and forth.

Mr. **GORDON**. Well, let's just level the playing field, stop them from being able to conscript, also make sure that the competitor is not also the regulator or, if so, that there are some protections, and then we can have a level playing field.

Mr. **SAWYER**. Well, you don't want to set up another bureaucracy to do a duplicative job of regulation, and I don't either. So perhaps we need to find out a way to overcome your misgivings about that.

Mr. **GORDON**. Sure.

Mr. **SAWYER**. I want you to know that I have as much discomfort over caps as I do about conscription.

Mr. **GORDON**. And I think that's all the more reason that we all need to sit down. Our bill—Bill may think this is the absolute, have-to-do perfect situation, but I think—and I'm just being facetious. I mean, let's sit down and work it out.

We're all in the same boat. We all want to see students get the best opportunity. We want to see the taxpayers get the best opportunity, and let's sit down and see what we can get worked out, but forcing schools into this program is, I don't think, the way to do that.

Mr. SAWYER. Thank you, Mr. Chairman.

Chairman HOEKSTRA. Well, we'll hear what Chairman Goodling has to say.

Chairman GOODLING. Well, of course, we can't set up a competitive situation until we find out whether the program works or doesn't work. You have to have—You know what the one program does. You have to find out what the other program does before you can have any kind of competition out there, and that's all we're asking.

We're saying that until we do as we said in the legislation, slowly move into something that no one knows anything about—No one in the administration knows what the outcome will be. They will be gone seven years from now when we have to start trying to make sure we collect this money. I want to know whether Hope College will have 97 percent collection in seven years from now as they now have under the existing systems.

That's what we need. We need time, but if we're going to try to present a budget here that takes us to 100 percent in two years time, there's no way to determine whether you have competition or don't have competition. There's no way to determine whether one program is better than the other.

Already, as you mentioned, the referee tries to make darn sure that they can disprove that the other side has anything to offer. This is what they do. Schools and their students participating in the FFEL program are still not being allowed to use the single free financial aid form, even though Congress said it is for all students. Now how can you have any kind of competition? How can you judge systems if you don't allow them to play under the same rules.

The direct loan consolidation program which the Department developed offered students more favorable deferment provisions and interest rates than the existing program. How do you check that? How do you compare that, if the referee is not going to allow the other side to play under the same rules that they are playing under?

FFEL participants are hindered by Department regulations in offering students more flexible repayment terms, as they are doing with direct lending. They do the exact same thing. They don't allow them to do anything with new, innovative electronic services, but they're going to use them.

So even after seven years, we may not be able to prove anything, because the referee does not allow a level playing field to find out, and that's all we're asking. No one on this committee, no one in the Congress, no one in the Senate, no one anywhere has any idea how well the program will work.

Now it's fine to say as a college, we love this. Well, of course. I mean, it's pretty simple and, as long as you don't have any responsibility about collecting any of the bucks, why wouldn't you love it? It's wonderful for the student.

Well, my wonderful chairman who—former chairman, who is a very good friend of mine, always also used to say what we need are all Pell grants, and we don't have to worry about defaults. That's a magnificent idea. I'm afraid that's the way we're heading right now if we allow us to move in two years without a seven-year opportunity to find out how the system is going to work, and that's where we're headed, Pell grants for everybody.

Well then, of course, the taxpayer is going to have something to say about that. So I appreciate your testimony. I hope we can get the Congress to understand, we'd better look at what it is we're going to do, because seven years from now we may discover that we made a terrible mistake. Why do that?

Why not find that out by having the two systems or three systems working at the same time, fairly, on a level playing field, and then make the decision which way we should go. So thank you very much for your testimony.

Mr. GORDON. Thank you for that question, Mr. Goodling.

Chairman HOEKSTRA. Mr. Reed? Mr. Scott?

Mr. SCOTT. Thank you, Mr. Chairman. There's one comment I'd like to make. It's not a question. You had indicated a problem with default rates at some schools. Particularly proprietary schools have very high default rates. One comment, I think, is important to note is some of those, if you look at their student body, they're taking a lot of people who, from situations—If half of them actually pay the money back, they've done a great service to society.

Some colleges, Ivy League colleges, for example, if they had a 2 percent default rate, they ought to be ashamed of themselves. So I mean, I don't think you ought to look at the default rate in and of itself as a measure of what effort is being made by the college.

Many of the proprietary schools take people who have no skills, no possibility of getting a job, and within eight months to a year or two years give them the skills to actually work. Some of them don't make it, but from where they started to where they ended up, they've done a great service to society.

I would hope that, whatever we do, we not look just at a default rate as a criterion as to whether a school is doing a good job or not.

Chairman GOODLING. Would the gentleman yield?

Mr. SCOTT. I yield to the gentleman.

Chairman GOODLING. I just wanted to indicate that we've come a long way with that, because of course, some of those fly-by-nighters did take great advantage of young people and, when we were smart enough to delay disbursement, we put them out of business, and now the goodies are there and the baddies are gone.

Mr. GORDON. Mr. Scott, I think you make a very good point, and as I have said earlier, I think there is certainly a role for proprietary schools and, clearly, many proprietary schools do deal with students who are at risk.

The legislation that this committee has put forth in 1993, the reform, still gives much room, but I think probably the most articulate spokesperson on this issue is Maxine Waters. Maxine—and I've heard her—I was going to say rant and rave. I probably shouldn't say that about Maxine but, let's say, be vocally articulate about these schools that will come into her community, into Watts, with no interest in those at risk children, those kids or those adults.

They come in there for one reason. They want to use them to get the Federal dollars, and it's so sad to see, you know, one woman with maybe a couple of children who wants to improve her life. So what she will do is she will ask her mother maybe, will you babysit for these children while I go to this school and try to learn a skill because, you know, I want to go off and be on my own.

Well, she does that. She goes to the program. Of course, these folks have no interest in whether or not they teach her a skill or if she gets a job later, because they've already got her money. Those are the folks we're trying to get to. Those are the folks that aren't helping those students that you and I are interested in. Those are the ones taking advantage of them.

I think that we can, hopefully, leave a wide door open for legitimate proprietary and community colleges, State vocational/tech schools, and at the same time, protect them; because don't you think we have a responsibility.

If you have a student that comes up and gets a Federal guaranteed loan in some way or a Federal loan through the direct lending and take it to XY or ABC Magic School, then don't you think that student thinks, well, if the Federal Government, Department of Education, is going to give me a loan to go to ABC Magic School, then they must be saying this is a good school, and so I can go there without concern.

I think we have a responsibility to those students.

Mr. SCOTT. I think—I hope we would not throw out the baby with the bath water. The experience that Representative Waters has and the experience in my district are entirely different. We've got schools with placement rates of 75–80 percent taking people with no job skills at all, no skills at all, no possibility of getting a job, and I would hope—and by just going to a default rate, you will put these places out of business.

In fact, we have put many of the very good schools that have taken people with no job skills, given them job skills, and by having this arbitrary level comparing a business college with an Ivy League school that takes just the top 1 or 2 percent of achievers—To have them competing at the same default rate standard is, in fact, ridiculous.

Mr. GORDON. Well, that's why we've set the standard high. Before a school is threatened, they have to have three straight years of 25 percent or more default rate; and if they do, even at that, then they have an appeal process to show that they are taking these at risk students.

Then we've put in additional leeway for traditional black schools and other schools like historically black schools. So there's been an effort to do that, and I hope that it is working, and this committee should look at it. If it can be fine tuned and made better, it ought to be made better.

Mr. SCOTT. Thank you, Mr. Chairman. I think I've made—We've both made our points.

Chairman HOEKSTRA. Thank you. Mr. Green.

Mr. GREEN. I have no questions.

Chairman HOEKSTRA. Well, thank you for your patience, for being last on the panel. You got more air time than anybody else. So thank you very much.

Mr. GORDON. Thank you.

Chairman Hoekstra. I'd like to invite the second panel forward. I will yield to my colleague, Mr. Reed, to introduce one of the panelists.

Mr. Reed. Thank you very much, Mr. Chairman. I'm delighted to welcome Lynn Fawthrop of Roger Williams University. Lynn is the Director of Financial Aid. She's a very active member of the financial aid community in Rhode Island and has been personally very helpful to my office in explaining all the intricacies of financial forms to thousands of Rhode Islanders and their more puzzled parents.

She's also very active on a national level as Chairperson of the Advisory Committee on Student Financial Assistance. Welcome, Lynn.

Thank you, Mr. Chairman, for your graciousness.

Chairman Hoekstra. Thank you. Now let me introduce the other members of the panel. We have Mr. Pierce who is President and Chief Operating Officer for Maine Education Services. We have Mr. Otto Reyer who is the Associate Vice Chancellor for Student Services and Director of Financial Aid for the University of California, Irvine. Boy, a heavy dose of California today.

Then we have Ms. Phyllis Hooyman who is Director of Financial Aid for one of the most outstanding colleges in the country today, Hope College, which is located in my hometown and which is also my alma mater. So welcome to you.

Chairman Goodling. Did they accept you into their college?

Chairman Hoekstra. I snuck in, but it was a great place. We'll start with Mr. Pierce.

STATEMENT OF RICHARD PIERCE, PRESIDENT AND CEO, MAINE EDUCATION SERVICES

Mr. Pierce. Thank you, Mr. Chairman, Members of the committee. My name is Dick Pierce. I am President of Maine Education Services. Just a quick background: I've spent my entire adult life in education. I've been a teacher, a college dean, served regionally in the New England Board of Higher Education, nationally in the Education Commission of the States, and have been involved, basically, in the last 20 years around the student loan program.

My organization provides a secondary market, or students, for the Federal loan program exclusively in Maine, and I'm just really pleased to have the opportunity to tell you a little bit about what we do. It was apparent when Senator Simon was talking about the full page ads that Sallie Mae had the opportunity to put before you, and Congressman Istook was talking about the limitless dollars that the Department seems to have to advertise, we have neither of those opportunities.

So for us to tell you what we are doing in a small rural, relatively poor State, is a unique opportunity for us, and we appreciate it. I also want to say that one of the reasons I am not here today is to take any potshots at the Department. I have long thought that we ought to be a partner with the Department in these programs and not a competitor.

I am also not here to tell you that I've seen in my 20 years in this business that programs have been run perfectly over the years. There have been lots of problems, but I can tell you that I think that there are an awful lot of good things that have been happening for a wide variety of reasons.

I guess it really doesn't matter what those reasons are, but there are an awful lot of good things that have happened over the last few months and years to make this program operate better than I've ever seen it operate in the past. I think we've made tremendous strides in making the delivery in servicing of student loans easier for students and for schools, and I think that's really what it is all about.

Not only have we been able to speed up the processing of applications and the transmitting of loan funds to schools, but we've also been able to cut administrative costs. Many of us, as a result, are trying very hard to pass those savings directly on to students in the form of lower interest rates, as we do in the Maine program, and reduced fees, coupled with always improved personalized service.

At the same time, we also aren't forgetting that we have a responsibility in the area of defaults. I am proud to say that Maine has always had one of the lowest default rates in the Nation, and it continues to have that. In fact, all of New England has a very, very low, traditionally low default rate.

I would also like to add that long before the Higher Education Act of 1965, Maine was making loans to students from the private sector, using funds. We nave a long tradition in this program.

I think that being a not-for-profit, State-based operation really allows us an awful lot of flexibility that, undoubtedly, a large Washington based organization really can't have. I think the approach that sometimes Washington takes of one size fits all is exactly what we, a State like Maine, are not.

We have tried to use whatever ingenuity we have to deliver the program and make it work for our people, because we are absolutely convinced that our whole future in the State of Maine is really dependent pretty much on how successful we are in moving our people on to some form of higher education.

I also would like to point out that, basically, many of the changes—most of the changes I've seen over the last couple of years are really pro-student, and I would also like to quickly mention three major nationwide innovations that are happening, just to make sure that they are on your agenda and bring them to your attention.

First of all, the National Student Loan Clearinghouse is an effort that is entirely in the private sector and has really been a response to the Congressionally mandated National Student Loan Data System, which really never got off the ground, to any great extent.

Now the private sector has taken over and, with absolutely no cost to the Federal Government, this is up and running at over 200 schools with well over 2 million students participating, and I think that this is a great new innovation.

Two other projects that are underway, the Educational Loan Management, better known as ELM, and, while we do not participate in this, there are a couple of our competitors on a regional basis that do use this.

I would like to bring this to your attention, because I think it's—Regardless of the fact that they are our competitors, I think that there are some things in there that are going to be better for students, and they ought to be allowed to institute these changes that they want, which really brings a standardized, computer based delivery system for student loans and services to the forefront.

Much like people have used Visa and MasterCard, ELM has some wonderful possibilities, and I think that it's something that should be allowed to move forward and not hindered by Department regulations.

Thirdly, the CommonLine Network is another important area, and I would like to point out that every single guaranty agency in the country has agreed to use the CommonLine.

In fact, a number of schools are already using it, and the initial results have been absolutely fantastic, and certainly they make sense in standardizing many of the things that we do in the industry.

Finally, I'd like to say that the Coalition for Student Loan Reform, which is a group of guaranty agencies, of lenders, secondary markets like ourselves, worked with financial aid officers who I consider the real experts, the people who are out in the front line who know this program probably better than all of us, to develop a list of recommendations for FFEL improvements.

Recently, the Coalition has conducted a survey which I have attached to my testimony which shows a dramatically improved level of services in the private loan programs, including the electronic processing of loans and 24-hour turnaround for applications in many areas. Basically, I think that the survey is a very good source of new information for you.

I also would like to just point out something about educational outreach, because too often I think perhaps you look at all of us as some people who provide some capital and service loans, and that's it. I would just like to at least read into the record and leave with you some photographs of some of the things that we do in Maine that are fairly unique.

We have a 34-foot Winnebago that goes to high schools. It has computers on board. It has printers. It has video, audio. It has Master's degree counselors. It helps students with financial aid forms, with career counseling. It goes to malls. It goes to adult education centers, to displaced homemakers, to youth correctional facilities, all over the State.

You know, in a State like Maine aspirations are everything, and many, many people in our State will not come through any front door. You have to go to them, and that's one of the things that we're trying very hard to do, to make them believe that they can go on to a variety of forms of higher education.

I can tell you from unlimited anecdotal evidence that we have had over the past year that this has been in operation that it's been just an unmitigated success and is just well received by people all over the State of Maine. I was going to say especially in the rural areas, but I guess basically we're one big rural area.

I would like to say that the program improvements which I have mentioned represent really just a sampling of some of the innovations, because every State has done something different.

We aren't all the same, and we really hope that we will be given a chance to present more fundamental proposals for reform and restructuring of the student loan programs when reauthorization comes up next year.

I guess it's been well pointed out here, and I don't want to be repetitive, but clearly, H.R. 530 is going to give all of us an opportunity to see how these two programs work, and that's all that we've ever asked. I have said time and again, if the government can do this better program—do this better—run this program better than we can, then they darn well ought to be running it.

I don't have any problem with that at all, but to just put this five-year program, which has worked so well in so many places, out of business, I think, is unconscionable, frankly, and I hope that it doesn't happen; because as Mr. Scott said in referring to throwing the baby out with the bath water, as far as I'm concerned, at least in Maine, we are the baby, and I hope that we don't get thrown out.

I would also just like to say that I would ask the subcommittee's assistance in monitoring the activities of the Department of Education. I hope, and I continue to wish, that they will be our partner in doing what's right not for the President and in doing what's right not for politicians, but doing what's right for people who deserve the very best programs.

It just becomes a political football far too easily, and it's people who fall through the cracks who really need all of our help. Collectively, I would like to think that we could work with the Department and not against it. I, for one, don't see them as a competitor.

I want to thank you very much for the opportunity to appear here before you today. I'm more than happy to answer any questions that you may have, but I would just, I guess, end in saying that in Maine and in many other States across this country we have programs that are working very, very well, and all too often sometimes we can paint with that broad brush and think that things are a mess, and they aren't in many places.

If you ask our legislature and our Governor and our senators and our schools and our people, do you have a good program, are you happy with it, I am very confident they would say, yes, and I hope that you will listen to all of them. Thank you very much.

Chairman **HOEKSTRA**. Thank you.

[The prepared statement of Mr. Pierce follows:]

Mr. Richard H. Pierce

Mr. Chairman and Members of the Subcommittee on Oversight and Investigations, my name is Dick Pierce. I serve as President and CEO of Maine Education Services. My organization provides a secondary market for students' Federal Family Education Loans in the state of Maine. I am honored to have the opportunity to testify today on the federal student loan programs.

Mr. Chairman, participants in the Federal Family Education Loan Programs have made tremendous strides in making the delivery and servicing student loans easier for students and schools. Not only have these improvements sped up the processing of applications and the transmitting of loan funds to schools, they have reduced administrative costs. And FFELP participants are passing these cost savings directly to students in the form of lower interest rates or reduced fees, coupled with improved, personalized service.

At the same time we are helping students and schools, we are not forgetting our responsibility to the American people who guarantee that student loans will be repaid. We have stepped up our efforts to reduce defaults, already saving money, and members of the FFELP community stand ready to come forward with additional ideas for reducing default costs.

To me it is truly exciting to be able to produce a tangible benefit to students, especially at a time when the costs of a college education are higher than ever. Far from being inefficient, I believe the network of non-profit and state-based organizations that provide loans under the FFEL program can lead the way in finding innovative ways to improve the student loan system. I believe the state-based systems have the flexibility to tailor their programs to meet the needs of each area of the country and to respond to changes in the education marketplace more quickly than can a centralized, purely federal, Washington-based program.

The changes made over the past two years in FFEL are unambiguously pro-student and represent the types of innovations that are unlikely to occur in the direct loan program once competition with FFEL is eliminated. I would like to explain what I mean by giving you examples of some of the approaches we have taken.

1. The National Student Loan Clearinghouse

In 1993 a group of participants in the FFEL Program decided to develop a computerized means of processing Student Status Confirmation Reports (SSCRs). This initiative, which became the National Student Loan Clearinghouse, was begun because of frustration with the Department of Education's long delay in starting the Congressionally mandated National Student Loan Data System. We were just tired of waiting to replace the inefficient and outmoded manual processes that had persisted for years, so we took the initiative ourselves to begin modernizing the process of tracking student enrollment. This modernization has proceeded, with great success, at no cost to the federal government.

The Clearinghouse is structured as a not-for-profit corporation with a board of directors representing schools, lenders, guaranty agencies, and secondary markets. It is successfully transforming the labor intensive, error-prone process of informing loan holders when students leave school so that the repayment process can be started. Many of the large audit exceptions identified by the Department over the past several years have occurred when the Student Status Confirmation process was not performed on an accurate or timely basis.

These problems, which resulted in many borrowers not entering repayment on time, led the private sector to develop its own solution. To date, 200 schools representing two million students are participating in the National Student Loan Clearinghouse. This brings loans into repayment with fewer errors, greatly reducing the need for contacts between schools and lenders to sort out individual students' cases. It should also greatly reduce the number of calls your district offices receive about loan repayment problems.

2. Educational Loan Management Resources.

A coalition of student loan delivery organizations has joined together to create the Educational Loan Management, or ELM, initiative, a universal, transparent delivery system for common student loan products and services. ELM is partly modeled on wildly successful examples of other shared national initiatives such as VISA and Mastercard, as well as the Cirrus and Plus ATM networks.

ELM has the potential to streamline the loan application process as well as the subsequent steps a loan follows. ELM would take advantage of the most modern technology available for the benefit of students, schools and the taxpayer. Unfortunately, that potential cannot be realized at this time, as I will explain later.

The ELM process consists of four components:

1) A customized diskette given to a student that allows the student to apply for any

combination of federal, state and institutional student aid--free of charge.

2) A service bureau that

(a) maps communications to and from a school's financial aid system,

(b) sends institutional data retrieved from student diskettes to the school's computer system,

(c) receives schools' transmissions of certified loan data, which are then switched to lenders and/or guarantors, and

(d) maintains a student database for each school.

3) A computer interface system which allows the school to access its student database for inquiry, maintenance, and statistical and status reporting.

4) A Central Disbursement Agent offering single-source electronic funds transfer (EFT) services to those schools not already so equipped.

The student loan community enthusiastically began adopting this system, but has run up against a regulatory brick wall. The Department of Education has asserted that the ELM system is "illegal" because, according to the Department, the Higher Education Act dictates that only the Secretary of Education can produce, distribute and process Free Applications For Student Aid (FAFSAs).

This interpretation of the law does not serve the best interest of students or schools. However, in light of the Department's position, ELM has dropped all plans to offer the FAFSA form on the ELM diskette.

I would like to note that ELM managers have made many attempts to arrange a meeting with the Department to discuss the issues in question, but the Department has not responded.

3. CommonLine.

The CommonLine Network is the result of an industry-wide standardization of electronic loan application formats, edits, response files and error messages. It puts the latest technology in electronic data exchange to work at schools by allowing school financial aid offices to communicate directly, via electronic mailbox, with every guaranty agency and many of the largest lenders and servicers in a single format.

The CommonLine Network also allows every guarantor and lender to "talk" to one another electronically. Like an ATM banking network, the Network will allow schools to automate fully their FFEL loan application process. Financial Aid Administrators no longer have to perform exception processing manually or have a specialized knowledge of guaranty agency formats. This ultimately saves them time and resources.

The CommonLine Network uses electronic mailboxes to send and receive data among schools, guarantors and lenders. Each participating organization and school has its own mailbox in the CompuServe on-line network. While a school can continue its direct electronic connection to its primary guarantor and/or lender, school-based software will be modified so that all other application data will be sent to the appropriate agency's electronic mailbox. It will be retrieved and processed daily and returned to the school's own electronic mailbox, where it can be retrieved and processed.

This process allows financial aid administrators to deal with many different guaranty agencies in a standard, simple format, so that the loans and guarantees can be processed quickly and efficiently.

Every guaranty agency in the United States has agreed to use the CommonLine Network, and a number of schools are already using it. For the 1995-96 lending cycle, close to 80 percent of the nation's guaranty agencies will have modified their software to make the full array of CommonLine services available to the schools they serve. Most guaranty agencies will be capable of receiving and transmitting data in the common formats through CompuServe no later than July, 1995. Those guaranty agencies that do not fully modify their software in the current lending cycle expect to offer the full complement of CommonLine services in 1996.

* * * * *

I would also like to share with this Subcommittee the work that the Coalition for Student Loan Reform (CSLR) has undertaken to promote additional improvements in services throughout the student loan industry. In July 1994, CSLR developed a list of recommendations to strengthen, improve and simplify the delivery and servicing of student loans. This list of recommendations was developed with the direct participation of financial aid professionals and reflects, in my view, what campus financial aid officers are looking for in improved services in student loan programs.

Following the development of these proposals, CSLR appointed a task force to flesh out the improvements and to monitor the implementation of them by lenders, guaranty agencies, and secondary markets. Recently, CSLR released the results of its efforts. I would like to share some of the results of a survey which reflect a dramatically improved level of services in the Federal Family Education Loan Program for those participants who have implemented the recommended changes:

- 86% of program participants indicated that they had achieved a 72-hour turn-around on loan applications. (64% of all respondents reported they can turn around loans from application to delivery of funds in 24 hours).
- 96% of participants indicated that they disbursed funds through electronic funds transfer (EFT) or a master check.
- 98% of participants indicated that they report updates in students status electronically. This process is facilitated through the National Student Loan Clearinghouse.
- 99% of participants combine loans of one type for a given borrowers into a single account so that the borrower writes a single check in the repayment process.
- 100% of the participants use the common deferment forms and maintain toll-free borrower help hotlines.

I have attached a complete copy of the CSLR/FFELP Improvement Survey to my testimony for your further review.

Educational outreach is something that we take very seriously and is something that the private sector programs have been working on in every state for many years. Every year, FFEL Program participants reach out to hundreds of thousands of students and families to make them aware of the opportunities available through higher education. This educational outreach brings the potential of higher education to many who would not otherwise consider it. FFEL participants reach out to students and families, helping them become aware of educational opportunities, select possible colleges or universities, find the means necessary to pay for their education, including scholarship searches, and become informed borrowers if loans are necessary.

These outreach efforts take many forms. There are programs for elementary school students, helping them learn to set goals, increasing their awareness of the vast array of career opportunities, and getting them and their parents started with early planning for college.

An even wider variety of services are available to high school families. FFEL participants sponsor college fairs where students can visit with college representatives and learn about financial aid. Presentations are made to parents and students at special college planning nights and in the classroom to career classes. We make resources, such as libraries of college catalogs and scholarship guides available to families. We offer free searches of scholarship and college databases. We help families complete their applications for financial aid, estimate their eligibility, answer many questions, and help them understand the sometimes confusing financial aid process.

As this Subcommittee considers the appropriate role of the private sector in the student loan programs, these activities and educational outreach efforts should be kept in mind. Put another way, Mr. Chairman, FFEL program participants often do more than just provide loan capital and service student loans in support of educational opportunity.

The program improvements which I have described to you today represent just a sampling of the innovations that the student loan industry is able to provide. We are hopeful that we will be given the opportunity to present more fundamental proposals for the reform and restructuring of the student loan programs in the context of the next reauthorization of the Higher Education Act. For this to happen, however, we need to assure that the FFEL Program remains stable and viable for the next two years. In this regard, I wholeheartedly endorse The Student Loan Evaluation and Stabilization Act of 1995, H.R. 530, as a means of achieving this objective.

I would like to highlight several provisions of H.R. 530 that are of particular importance to the student loan industry:

H.R. 530 removes references to a "transition" to the Federal Direct Student Loan Program and curtails the virtually unlimited authority of the Department of Education to effectuate an arbitrary shut-down of the FFEL Program.

Frankly, Mr. Chairman, events of recent months have convinced me and others in the FFEL Program that the Department of Education is not interested in working with us on program improvements, such as the ones I have shared with you today. For this reason, H.R. 530 is not only necessary, but imperative. The Department of Education in my view should not be acting as our competitor, it should be acting as a public-service minded regulator, encouraging improvements in service to students and families.

I would ask this Subcommittee's assistance in monitoring the activities of the Department of Education to assure that proposals coming from the student loan industry that improve the quality of service to students who depend on FFEL and will continue to depend on that program for the next several years, are considered on the basis of their merit.

I would also ask that the Subcommittee undertake a careful review of the implementation of the Federal Direct Student Loan Program. The goal of this review should be not only to assure that all funds expended in the program are properly accounted for, and that services to students are of the highest possible quality, but also to identify those features of the Direct Loan Program that might be used as models for an improved program involving the private sector.

As the Chief Executive Officer of Maine's Student Loan Secondary Market, I am very proud of the private sector's record in promoting the availability of funds to attend postsecondary institutions. I believe that in the long run, the private sector, and not the federal government, will be identified as the preferred means of achieving this public goal. The enactment of H.R. 530 will help achieve this objective.

Thank you for the opportunity to testify before this Subcommittee today. I would be pleased to answer any questions the Members of the Subcommittee might have.

Federal Family Education Loan Program
Improvements

Survey Results

May, 1995

CSLR Coalition for Student Loan Reform
1075 Connecticut Avenue, NW ▪ Suite 634 ▪ Washington, D.C. 20009 ▪ 202/328-6109 ▪ (fax) 202/328-1163

FFELP Improvements Survey Results

In July of 1994, the Coalition for Student Loan Reform (CSLR) released a series of recommendations to strengthen, improve and simplify the way student loans are delivered and serviced under the guaranteed loan program. These recommendations were endorsed by the five major national education loan associations--the National Council of Higher Education Loan Programs (NCHELP), the Education Finance Council, the Consumer Bankers Association, the Student Loan Servicing Alliance and the Coalition of Higher Education Assistance Organizations--as well as fifty individual education loan organizations (see attached list).

The recommendations were developed with the direct participation and input of professionals from the financial aid and student lending communities and, in particular, reflect what campus financial aid officials have said they want most in an improved aid delivery process and guaranteed student loan program. An important point about CSLR's recommendations is that they are principally improvements that organizations can make on their own, and in cooperation with one another, under current law. This means the widespread endorsements CSLR received are key to timely and efficient implementation of the recommendations.

Soon after the release of its report last year, CSLR appointed a Task Force that is representative of the various participants in the guaranteed student loan community to work with NCHELP and other groups to help guide and monitor the implementation of these recommendations both locally and nationwide. As part of this effort, CSLR surveyed those organizations supporting our recommendations in the month of April to report to the broader higher education community the progress on many fronts to make an improved Federal Family Education Loan Program a marketplace reality.

The survey results speak for themselves. In the pages that follow you will see evidence of the widespread adoption and implementation of innovations and services that simplify loan application processing, provide for timely delivery of funds, facilitate the easy exchange of data, streamline loan servicing, and ease student loan repayment. The percentages associated with each service innovation is a reflection on the number of guarantors and/or secondary markets from whom this service is available.[1] There is also tremendous innovation going on in areas beyond those addressed by CSLR's recommendations which are captured in the section marked "Special Services." Schools and students who wish to know more about the specific programs available are encouraged to inquire about them through your own 'service providers' directly.

CSLR's work and that of its endorsing organizations continues as we strive to fulfill our joint commitment to provide students superior service and a continued dependable, cost-efficient source of education loan credit for students, families and taxpayers.

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[1] Forty-two of a possible fifty responses were received and tallied as of May 1, 1995. The responses were tabulated using "weighted averages" based on a respondent's annual loan volume in order that the percentages reported would more accurately reflect the degree to which these innovations are available across the student borrower population served.

FFELP Improvements Survey Results

Service Innovation	Availability
Applying for Aid Made Simpler	
• Use of Common Stafford & PLUS Loan Applications	100%
• Processing Applications Electronically (90% of respondents report that more than half of all their loans are processed electronically; 35% report that three-fourths or more of their loans are electronically processed)	100%
• Use of FAFSA Data to Preprint the Common Application	69%
• Preprinting of Common Applications for Repeat Borrowers	77%
Assuring On-Time Delivery of Funds	
• 72-Hour Turn-Around (Error-Free Application to Guarantee) 24 Hours - 64% 48 Hours - 80% 72 Hours - 86%	86%
• Disbursements via EFT and/or Mastercheck (18% of respondents report disbursing more than half of all funds electronically or by Mastercheck)	96%

FFELP Improvements Survey Results

Service Innovation	Availability
Simplifying the Exchange of Data	
• Reporting Changes & Student Status Updates Electronically	98%
• Use of the Standard Student Status Confirmation Report Format	70%
• FFELP CommonLine℠ -- Use of common data formats to allow schools to transmit and receive data one way (regardless of the number of lenders & guarantors) At highest level of participation (Level III): 1995/96 - 83% 1996/97 - 90% [Note: More recent data reported by NCHELP show all guarantors will participate.]	93%
Streamlining the Loan Servicing Process	
• Life-of-the-Loan Servicing. Secondary markets that leave the loan at the same servicer as the originating lender	70%
• Guarantee Transfers. Procedures/agreements are in place to transfer guarantees when a borrower is identified as having loans under different guarantors.	75%
Easing Repayment	
• Combine All Loans of One Type for a Given Borrower (so s/he has only one payment per month)	99%
• Offer Students the Option of Repaying Through a Direct Debit from Their Bank Accounts Each Month	83%

FFELP Improvements Survey Results

Service Innovation	Availability
Easing Repayment (cont'd)	
Common Deferment Forms	100%
Borrowers Are Sent Borrower Deferment and Forbearance Information with Their Repayment Disclosure	77%
Toll-Free 'Borrower Help' Hotlines	100%
Student Loan Debt Management Counseling	94%
Default Rehabilitation Programs	92%
Graduated Repayment	100%
Income Sensitive Repayment Option in Place by July 1, 1995	92%

Special Services

Pre-Application

- Mobile counseling unit for high schools (providing scholarship, grant and loan information)
- Financial planning for college (assessing need and pre-admission assistance)
- Scholarship search program
- Early intervention grants

FFELP Improvements Survey Results

Special Services (cont.)

Funds Delivery
- Central EFT disbursement agent
- On-line EFT reconciliation
- Payment of the 1% guarantee fee for the student

Easing Repayment
- Interest rebate to reward consistent, on-time repayment
- Community service/loan forgiveness program

Enhancing Collections
- Early identification/intervention for borrowers heading toward default
- Wage garnishment
- Suspension of professional licenses for defaulted borrowers
- State income tax refund offset program for defaulted loans

School Support
- College entrance & exit counseling
- Training of school financial aid personnel
- On-site technical assistance for schools

CSLR Program Improvement Recommendations

Supporting Organizations

American Student Assistance
Arkansas Student Loan Authority
Brazos Higher Education Authority
Central Texas Higher Education Authority
College Foundation Inc. (NC)
Colorado Student Obligation Bond Authority
Connecticut Student Loan Foundation
Delaware Higher Education Loan Program
Florida Department of Education - OSFA
Georgia Higher Education Assistance Corporation
Greater East Texas Higher Education Authority
Illinois Designated Account Purchase Program
Illinois Student Assistance Commission
Indiana Secondary Market for Education Loans, Inc.
Iowa College Student Aid Commission
Kentucky Higher Education Assistance Authority
Maine Education Loan Marketing Corporation
Maryland Higher Education Loan Corporation
Mississippi Higher Education Assistance Corporation
Nebraska Higher Education Loan Program
Nebraska Student Loan Program, Inc.
Nellie Mae
New Hampshire Higher Education Assistance Foundation
New Mexico Student Loan Guarantee Corporation
North Carolina State Education Assistance Authority
North Texas Higher Education Authority
Northwest Education Loan Association
Ohio Student Aid Commission
Oklahoma State Regents for Higher Education
Oklahoma Student Loan Authority
Oregon State Scholarship Commission
Panhandle-Plains Higher Education Authority
Pennsylvania Higher Education Assistance Authority
Rhode Island Higher Education Assistance Authority
Rhode Island Student Loan Authority
South Carolina Student Loan Corporation
Southwest Student Services Corporation
Student Loan Finance Corporation
Student Loan Fund of Idaho, Inc.
Student Loan Guarantee Foundation of Arkansas
Student Loans of North Dakota
Tennessee Student Assistance Corporation
Texas Guaranteed Student Loan Corporation
The Student Loan Funding Corporation
USA GROUP, Inc.
Utah Student Loan Programs
Vermont Student Assistance Corporation
Virginia Student Assistance Authorities
Volunteer State Student Funding Corporation
Wyoming Student Loan Corporation

Mr. HOEKSTRA. Thank you. Ms. Hooyman.

STATEMENT OF PHYLLIS HOOYMAN, DIRECTOR OF FINANCIAL AID, HOPE COLLEGE

Ms. HOOYMAN. Mr. Chairman, Members of the committee, my name is Phyllis Hooyman, and I am Director of Financial Aid at Hope College in Holland, Michigan. We are very pleased to be one of the 104 institutions chosen to participate in the first year of the William D. Ford Federal Direct Loan Program.

Hope College is a four year liberal arts college enrolling approximately 2,800 students. Under the Federal Direct Student Loan Program in 1994–1995, we administered approximately $6.7 million in direct loans for 2,000 borrowers, representing 71 percent of my student population. Our repayment rate under this program, as Mr. Goodling pointed out, stands at 97 percent.

I have worked within the financial aid profession for over 17 years. I am currently serving as an appointee of Governor John Engler on the Michigan Higher Education Assistance Authority, am a member of the Board of Directors for the National Association of Student Financial Aid Administrators, and am a past president of the Michigan Student Financial Aid Association. I certainly appreciate this opportunity to testify on behalf of the Federal Direct Student Loan Program.

I would note with you that there are now over 50 Michigan institutions participating in direct lending. Within the four-year public sector, 13 of our 15 public universities or 87 percent are now direct lending institutions. Almost one-third of our smaller independent colleges are direct lending institutions, along with six of our community colleges and 25 of our proprietary institutions. On a national level, we now have 2,000 institutions accepted into the direct lending program.

Neither Hope nor these other institutions entered into the direct loan program without serious deliberation. What were the greatest motivating factors for making such a major decision? Simply stated, we believed that the Federal Family Educational Loan program was seriously flawed and ready to collapse under its own weight.

For our financial aid office, the FFEL program had become an administrative nightmare. Approximately 80 percent of the complaints received by our office from students and parents were connected in some way to the FFEL program, relating to late checks, lost checks, no checks, incorrect checks, ineligible checks, et cetera.

The reported problems related not only to current borrowers, but also to borrowers who had entered repayment, problems with the collection agency, confusion as to the holder of the loan, servicing complaints, et cetera. The FFEL program had become the most labor intensive financial aid program in our Financial Aid Office.

Under the FFEL program, we had to deal with hundreds of different lenders, ranging from small local credit unions with very little program sophistication all the way to large international banks, along with 50-plus guarantee agencies.

Each of these lenders and each of these guarantee agencies has different policies and procedures. It's just the nature of the beast that they wish to be competitive and take different approaches. As a result, our office shelves were lined with thick policy manuals, each from a different guarantor and each containing different policies.

Under the FFEL program, we were never able to counsel our students in-house as to the accurate status of their loan proceeds. Instead, we were constantly having to call various lenders and guarantors all across the country simply to determine the status of a student's loan or check.

Members of my staff would typically spend one to two hours simply trying to determine the loan/check status of only one student. Given the growing complexity of the FFEL program and the growing frustration of our students and parents, we firmly believed that there had to be a better way in which to deliver loan funds to our population.

Direct lending has indeed been the answer for Hope College and many other institutions. Having successfully implemented direct lending at our institution in 1994–1995, I would like to share the following program assessments with you:

> Hope College has received very positive responses from both its students and parents relative to the streamlined nature of direct lending. Compared to the paper intensive nature of the FFEL program, students are very pleased that one signature on one promissory note replaces waiting in line twice a year to sign their loan checks. The process is simple and very user friendly.

Fund management and distribution is much easier under direct loans. Under the prior FFEL program, if a student for whom you had processed a loan did not enroll at your school, these loan dollars were considered student specific and had to be returned to the lender in question, even though that same institution might have 50 other students eligible for those same loan funds. However, as a full origination direct lending school, we can simply reverse the loan credit on the account of the ineligible student and transfer those funds immediately to the account of an eligible student.

As a result, hours of administrative labor and paperwork are saved. This simple concept of fund transferral is inherent to the direct lending model design, but is not possible under the current FFEL program due to the nature of the program's basic configuration involving multiple lenders.

Students and parents have also been pleased in terms of how much more quickly they receive their loan funds. Under the FFEL, our students often had to wait four to six weeks to secure a loan check. We now have the ability to credit a student's account with his or her loan proceeds within as little as five minutes after securing a signed note.

The direct lending model is easily understood by our student and parent borrowers. Under the prior lender/guarantor model, we had to explain to the borrower the roles of the lender, the guarantor, the school, a servicing company, the Federal Government, the borrower, and the secondary market, and how their loan might be sold several times throughout the repayment process.

Now under direct lending, attention is focused solely on three entities, the student, the school and the Federal servicer. As a result, students are less confused by the process. Most importantly, we can assure our students that under the direct lending program, their loans will never be sold.

This is a very important feature of direct lending in that the selling of loans and the changing of the loan holder have been closely linked to the potential for default.

We have also found that there is less administrative burden for both our Financial Aid Office and our business office. The paper chase and accompanying liabilities of check handling are a thing of the past. One signed promissory note suffices for the full loan period.

Our business office is very excited about direct lending, due to the significant reduction in administrative responsibilities for their office as compared to the FFEL program. As a result of this reduction, they are better able to serve and direct their limited personnel resources to other areas of student service.

I would note that some first-year institutions have reported that they have realized financial savings under direct lending, due to the program's labor efficiencies. This has allowed them to reduce the number of positions in their Financial Aid Office and/or business offices.

There has also been an improved cash flow for both our students and the college. Students and parents feel that they are better served by the efficiency of the direct lending program in that they can more quickly access their loan funds. Our business office has experienced a marked improvement in our cash flow. This office is also very pleased to be relieved of the labor intensive burden of multiple check disbursements, saving us over 4,000 paper transactions annually.

The repayment process is much more easily understood by our students. One of the most attractive features of direct lending lies in the fact that the student will have one servicer and loan holder throughout the life of the loan, due to the fact that their loan will never be sold.

I would have to contradict Mr. Gordon in the sense that, when we did discuss this with the Department of Education, they have indicated that to date they have collected approximately $8.4 million in direct loans. I believe they have also collected in that figure 85,000 repayments in terms of actual payments.

This has been serviced by the AFSA Corporation, which is a division of Fleet Bank. Our students and parents have been very pleased with the service and their interactions with the servicer, and we have not received any complaints to date about those interactions, which was, by no means, the case under the FFEL program.

I would point to this as a joint venture between the U.S. Department of Education and AFSA Corporation, in that it demonstrates how the Federal Government is contracting successfully with private industry through the competitive bidding process.

From our perspective, very simply, the key advantage is that of institutional control. Our Financial Aid Office now controls the entire loan process. It is no longer necessary to cut refund checks back and forth with a lender. If there is any problem with the loan amount throughout the loan period, we can simply adjust it in-house in an accurate and efficient manner.

It is no longer necessary for us to spend hours tracking on the loan status of a student. We simply access our direct lending software in the office to determine a student's loan status. We no longer struggle to comply with the various administrative policies and procedures of the various national guarantors and several hundred lenders.

When Hope decided to participate in direct lending, we had little direct experience with the Department of Education in terms of computer software and electronic communication. At the outset, program detractors often advised me that Hope College simply did not have the ability to implement direct lending, and that smaller schools were handicapped in the area of technology.

I am very pleased to report that the direct lending software was installed in our office with modest effort and has worked very effectively for my staff. I would also underscore that our interactions with the U.S. Department of Education and its contractors have been excellent throughout the entire implementation process. Whenever we had a problem or a question, we received very timely responses and effective problem resolution.

Why has Hope College and almost 2,000 institutions nationally decided to participate in the Federal Direct Student Loan Program? Our only vested interest is that of securing the finest loan service for our students. In fact, I would stress with each Member of this committee that the most forthright and unbiased assessment of direct lending will come to you from the student borrowers themselves and the participating financial aid professionals.

These individuals are not concerned about the loss of their corporate profits. They are simply interested in securing the best quality loan program for students. For Hope College and these 2,000 other institutions, the direct lending model delivers exactly what we needed, a user friendly loan system for our students which we can fully control.

Proposals have been put forward to apply an artificial cap to the Federal Direct Student Loan Program, limiting the number of future participants. Rather than applying such a cap, I would urge you to support the concept of an open marketplace and to allow for institutional choice.

For the first time that I can remember in my career as a practicing financial aid professional, the Congress has granted institutions a programmatic choice at the local level. We are actually able to decide which program best serves our students and our institution.

This choice worked extremely well for Hope College and 103 other institutions in 1994–1995. Now almost 1,900 other institutions have exercised that local choice as well.

All institutions should have the freedom to choose. Institutions are extremely sensitive to the happiness or displeasure of their students and parents. If any schools come to the conclusion that direct lending is not effectively serving their student customers, these schools will quickly vote with their feet and leave the program.

Schools should have that option. In the same manner, they should also have the right to select the loan program of their choice and not be locked out as the result of a legislated cap.

I urge you to allow for open competition between the FFEL and FDSL programs, and let the market determine their success. This type of open competition is very healthy and will only serve to improve student loan service. There is great potential here for an effective and successful student loan delivery system.

It is my sincere hope that you will listen carefully to the message of the direct lending schools, and that you will support the concepts of an open marketplace and local choice.

I thank you for this opportunity to make these comments and would be glad to respond to questions or provide further comment at a later date. Also, I would like to ask that it be entered into the record. I have with me a statement recently passed, a resolution by the National Association of Student Financial Aid Administrators, representing approximately 3,200 institutions nationally, in which they also urge an open marketplace. So I would like to submit that for the record. Thank you.

Chairman HOEKSTRA. Thank you.

[The prepared statement of Ms. Hooyman follows:]

Phyllis K. Hooyman

Mr. Chairman, Members of the Committee, my name is Phyllis Hooyman. I am Director of Financial Aid at Hope College in Holland, Michigan. We are very pleased to be one of the 104 institutions chosen to participate in the first year of the William D. Ford Federal Direct Loan Program.

Hope College is a four year liberal arts college enrolling approximately 2,800 students. Under the Federal Direct Student Loan (FDSL) Program in 1994-95, we administered approximately $6.7 million in direct loans for 2,000 borrowers (representing 71% of our students). Our repayment rate under the FFEL/FDSL Programs stands at 97%.

I have worked within the financial aid profession for 17 years, am currently serving as an appointee of Governor John Engler on the Michigan Higher Education Assistance Authority, am a member of the Board of Directors for the National Association of Student Financial Aid Administrators, and am a past president of the Michigan Student Financial Aid Association. I appreciate this opportunity to testify on behalf of the Federal Direct Student Loan Program.

I would note that there are now over fifty Michigan institutions participating in direct lending. Within the four year public sector, 13 of our 15 public universities (87%) are now direct lending institutions. Almost one third of our smaller independent colleges are direct lending institutions along with six of our community colleges and 25 of our proprietary institutions. On a national level, close to 2,000 institutions are now accepted into the direct lending program.

Neither Hope College nor these other institutions opted for direct lending without serious deliberation. What were the greatest motivating factors for making such a major decision? Simply stated, we believed that the Federal Family Educational Family Loan (FFEL) Program was seriously flawed and ready to collapse under its own weight.

For our Financial Aid Office, the FFEL Program had become an administrative nightmare. Approximately eighty percent of the complaints received by our office from students and parents were connected in some way to the FFEL Program (late checks, lost checks, no checks, incorrect checks, ineligible checks, etc.) The reported problems related not only to current borrowers, but also to borrowers who had entered repayment (problems with the collection agency, confusion as to the holder of a loan, servicing complaints, etc.) The FFEL Program had become the most labor intensive financial aid program administered by our Financial Aid Office.

Under the FFEL Program, we had to deal with hundreds of different lenders (ranging from small local credit unions with little program sophistication to large international banks) and fifty plus national guarantee agencies. Each of these lenders and guarantee agencies has different policies and procedures. As a result, our office shelves were lined with thick policy manuals, each from a different guarantor and each containing different policies.

Under the FFEL Program, we were never able to counsel our students in-house as to the accurate status of their loan proceeds. Instead, we were constantly having to call various lenders and guarantors all across the country to determine the status of a student's loan or check. Members of my staff would typically spend one to two hours simply trying to determine the loan/check status of ONE student. Given the growing complexity of the FFEL Program and the growing frustration of our students and parents, we firmly believed that there had to be a better way in which to deliver loan funds to students.

Direct lending has been the answer for Hope College and many other institutions. Having successfully implemented direct lending at our institution in 1994-95, I would like to share the following program assessments with you:

Hope College has received **very positive responses from both its students and parents relative to the streamlined nature of direct lending**. Compared to the paper intensive nature of the FFEL Program, students are very pleased that one signature on the Promissory Note replaces waiting in line twice a year to sign their loan checks. The process is simple and user friendly.

Fund management and distribution is much easier under direct lending. Under the prior FFEL Program, if a student for whom you had processed a loan did not enroll at your school, these loan dollars were considered student specific and had to be returned to the lender in question (even though the institution might have fifty other students eligible for those same loan funds). However, as a full origination direct lending school, we can simply reverse the loan credit on the account of an ineligible student and immediately credit those dollars to the account of another eligible student. As a result, hours of administrative labor and paperwork are saved. This simple concept of fund transferral is inherent to the direct lending model design but is not possible under the FFEL program due to the nature of the program's basic configuration involving multiple lenders.

Students and parents have also been pleased in terms of how **much more quickly they receive their loan funds**. Under the FFEL Program, our students often had to wait four to six weeks to secure their loan funds. We now have the ability to credit a student's account with his/her loan proceeds within as little as five minutes after securing a signed note.

The direct lending model is **easily understood by our student and parent borrowers**. Under the prior lender/guarantor model, we had to explain to the borrower the roles of the lender, the guarantor, the school, a servicing company, the federal government, the borrower, and the secondary market (and how their loan might be sold several times throughout their repayment period.) Now, under direct lending, **attention is focussed solely on the student, the school, and the federal servicer**. As a result, **students are less confused by the process.** Most importantly, **we can assure our students that, under the direct lending program, their loans will never be sold**. This is a very important feature of direct lending in that the selling of loans and the changing of the loan holder have been closely linked to the potential for default.

We have also found that there is **less administrative burden** for both our Financial Aid Office and our Business Office. The paper chase and accompanying liabilities of check handling are a thing of the past. One signed promissory note suffices for the full loan period. Our Business Office is very excited about direct lending due to the significant reduction in administrative responsibilities for their office as compared to the FFEL Program. As a result of this reduction, they are better able to direct their limited personnel resources to other areas of student service. I would note that some first year institutions have reported that they have realized financial savings under direct lending due to the program's labor efficiencies. This has allowed them to reduce the number of positions in their Financial Aid and/or Business Offices.

There has been an **improved cash flow for both our students and the**

college. Students and parents feel that they are better served by the efficiency of the direct lending program in that they can more quickly access their loan funds. Our Business Office has experienced a marked improvement in our cash flow. This office is also very pleased to be relieved of the labor intensive burden of multiple check disbursements (**saving over 4,000 transactions per year.)**

The **repayment process is much more easily understood by our students**. One of most attractive features of direct lending lies in the fact that **the student will have ONE servicer/loan holder throughout the life of his/her loan due to the fact that their loan will never be sold.** Nationally, over $8.4 million worth of direct loans have already entered repayment and have been serviced by AFSA Corporation (a division of Fleet Bank). Our students and parents have been very pleased with their interactions with the servicer and we have not received any complaints to date (which was by no means the case with the FFEL Program). This joint venture between the U.S. Department of Education and AFSA Corporation demonstrates how the federal government is contracting successfully with private industry through the competitive bidding process.

From our perspective, **the key advantage is simply that of institutional control**. Our Financial Aid Office now controls the entire loan process. It is no longer necessary to cut refund checks back and forth with a lender. If there is any problem with the loan amount throughout the loan period, we can simply adjust it in-house in an accurate and efficient manner. It is no longer necessary for us to spend hours tracking on the loan status of a student. We simply access our direct lending software to determine a student's loan status. We no longer struggle to comply with the various administrative policies and procedures of the various national guarantors and several hundred lenders.

When Hope College decided to participate in direct lending, we had little direct experience with the Department of Education in terms of computer software and electronic communication. At the outset, program detractors often advised me that Hope College did not have the ability to implement direct lending and that smaller schools were handicapped in the area of technology. I am very pleased to report that the direct lending software was installed in our office with modest effort and has worked very effectively for my staff. I would also underscore that our interactions with the U.S. Department of Education and its contractors have been excellent throughout the entire implementation process. Whenever we had a question or encountered a problem, we received very timely responses and effective problem resolution.

Why have Hope College and almost 2,000 institutions nationally decided to participate in the Federal Direct Student Loan Program? Our only vested interest is that of securing the finest loan service for our students. In fact, I would stress with each member of this committee that the most forthright and unbiased assessment of direct lending will come to you from the student borrowers themselves and the participating financial aid professionals. These individuals are not concerned about the loss of corporate profits; they are simply interested in securing the best quality loan program for students. For Hope College and these 2,000 other institutions, the direct lending model delivers exactly what we needed -- **a user friendly loan system for our students which we can fully control.**

Proposals have been put forward to apply an artificial cap to the Federal

Direct Student Loan Program, limiting the number of future participants. Rather than applying such a cap, I would urge you to support the concept of an open marketplace and to allow for institutional choice. For the first time that I can remember in my career as a practicing financial aid professional, the congress has granted institutions a programmatic choice at the local level. We are actually able to decide which program best serves our students and our institution. This choice worked extremely well for Hope College and 103 other institutions in 1994-95. Now, almost 1,900 other institutions have exercised that local choice as well.

All institutions should have the freedom to choose. Institutions are extremely sensitive to the happiness or displeasure of their students and parents. If any schools come to the conclusion that direct lending is not effectively serving their student customers, these schools will quickly vote with their feet and leave the program. Schools should have that option. In the same manner, they should also have the right to select the loan program of their choice and not be locked out as the result of a legislated cap.

I urge you to allow for open competition between the FFEL and FDSL Programs and let the market determine their success. This type of open competition is very healthy and will only serve to improve student loan service. There is great potential here for an effective and successful student loan delivery system. It is my sincere hope that you will listen carefully to the message of the direct lending schools and that you will support the concepts of an open marketplace and local choice.

I thank you for the opportunity to make these comments and would be glad to respond to questions or provide further comment at a later date.

Mr. HOEKSTRA. Dr. Ryan.

STATEMENT OF DIANE RYAN, DIRECTOR OF FINANCIAL AID, CALIFORNIA STATE UNIVERSITY, NORTHRIDGE

Ms. RYAN. Thank you, Mr. Chairman. As a financial aid administrator with 20 years of experience in delivering student financial aid, I know a great deal about student loans. I have conducted research on student loan repayments and defaults and, over the course of my career, I have processed some 85,000 loans at the State universities in California where I have worked.

During that time, student loans became big business, and that business was in dire need of reform, reform that has centered largely around one theme: Simplification.

In the name of reform, however, the acrimonious debate over student loans has raged on with the allegorical pitting of the profiteering middlemen of the banking industry against the entrenched bureaucrats of the government. It has been difficult to sort out the fact from the fiction, the truth from the hype, the cost from the savings, and the current political climate has only intensified competing ideologies.

As a financial aid director, I believe that student need is the overarching umbrella under which all other issues should fall in this debate, and students should be the beneficiaries of this reform.

There are many ways to reform student loans, and one of them was the Federal Direct Student Loan Program, which was based on the solid notion of eliminating the complexities of borrowing for college. Dedicated financial aid people, colleagues I respect enormously, set out to create a program that worked for students and for schools. Direct loans resulted from this vision.

I might add that the lack of responsiveness by many of the players in the Federal Family Education Loan Programs, the banks, the regulators, the secondary markets, the guarantee agencies, collection entities, and the like, provided much of the impetus for direct loans as well.

Direct loans, from all appearances, have resolved many of the front end problems that plagued the FFELP. The Department of Education has demonstrated an unparalleled level of support to the program and has committed the resources necessary to make it work for the participating schools. This has been good for students and good for schools. However, direct loans are not the only method by which borrowing can be simplified and improved with similar benefits.

Because of direct loans, the lending community sat up and took notice. Fueled in part by the very competition posed by direct government lending programs, lenders have become far more sensitive to the demands of the marketplace and are trying to meet the needs of students and schools in new and creative ways.

For some of us, the option of having Federal Family Education Loans financed through banks and other financial institutions remains an [illegible]tive one. I am glad that educational institutions still have a choice on financing options to offer students.

At my campus, because we were in the throes of recovering from the massive damages of the Northridge earthquake, moving to a completely new system of student borrowing through direct loans did not seem feasible, and we opted, with the help of a consortium of lenders and the ELM resources, in conjunction with the California Student Aid Commission, to remain in the FFELP program and work toward its improvement. This has worked extremely well for us.

We now process our 7,000 annual student loan volume very differently than we did in the past. I believe that our best chance for continued success in that regard is to take advantage of innovations offered by private enterprise in partnership with the public sector. ELM and other entities like it continue to work to make such innovations a reality.

We have an obligation to keep pace with the technologies that our student consumers have come to demand and that we can offer now, innovations in the way in which students apply for aid and the way in which we move and validate required data. Enormous efficiencies can be realized through the technological innovations offered by private enterprise, and we must remove the regulatory impediments to such innovations.

Our new FFELP process at Northridge represents an enormous improvement in processing steps and time to delivery of aid. My students can stay with the banks with which they have done prior student loan business. I like the fact that my students borrow from lending institutions and that they establish a banking relationship in this way.

Lenders come to my campus and assist with the counseling of borrowers on credit obligations and repayment information. The student borrower relationship with the lender is something that I view as positive. It teaches a borrower about borrowing.

From my perspective, this is a greatly simplified FFELP process and has made student loan processing a very different animal than it was a few years ago. I believe it is only the beginning of what can be done to improve student loan delivery.

Some would argue that the Department of Education is the best entity for making student loans and that it should be ready to handle all of the Nation's loan volume. Others hold a few that the FFELP is so structurally flawed that it has to be scrapped. Neither position should be absolute.

I've seen problems in the student loan program, and I have seen thoughtful and collaborative solutions being offered. I believe that competition in student lending is a good thing, and the result has been a greatly improved level of service, responsiveness, accountability from both the public and the private student loan makers, and a continuation of this innovative spirit can only serve to improve student loans overall. Thank you.

[The prepared statement of Ms. Ryan follows:]

Testimony for the Committee on Economic and Educational Opportunities
Subcommittee on Oversight and Investigations
U.S. House of Representatives
Washington D.C.

May 23, 1995

L. Diane Ryan, Ph.D.
Director of Financial Aid
California State University Northridge

Summary

Money for financing college now comes largely from student loans resulting in a growth in loan volume and complexity which has been significant. The need for reform in the student loan industry has been acute and debate on student loans rages on. Central to the debate has been the theme of simplification. The ways in which loans can be processed and delivered have changed dramatically in recent years and new methods for student loan application and delivery are being developed.

Federal Direct Loans have met with success in meeting the front-end processing needs of students and schools. Other private sector initiatives have also come to the fore which are showing enormous promise in achieving similar objectives of simplification with new efficiencies.

California State University Northridge has been selected to participate in the Direct Lending Program but has elected to delay implementation pending a determination of the best, continued lending option for the campus. Northridge has opted to continue participation in the Federal Family Education Loan Program because of services obtained through a consortium of lenders (Education Loan Management Resources) which offers many of the same benefits of Direct Lending, but has not required a campus conversion to an entirely new loan program.

Competition in the student loan industry between the private capital providers and government funded loans has been beneficial. It has improved service, responsiveness and accountability from both private and public loan makers. A continuation of the public/private partnership focused on innovation, technological improvements, standardization and continued simplification is warranted. This approach would offer students and schools a choice of alternatives for borrowing, providing desirable options for long-term education financing.

Testimony for the Committee on Economic and Educational Opportunities
Subcommittee on Oversight and Investigations
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May 23, 1995

L. Diane Ryan, Ph.D.
Director of Financial Aid
California State University Northridge

As a financial aid administrator with twenty years of experience in delivering student financial aid, I know a great deal about student loans. I have conducted research on student loan repayments and defaults and, over the course of my career, I have processed some 85,000 loans at the state universities in California where I have worked. Student loans have become *the* primary funding vehicle for college--not a trend that we in the financial aid community consider to be a healthy one. However, because of declining grant support for college students, student loans have become big business. That "business" became incredibly complicated and was in dire need of reform--reform that has centered largely around one theme: simplification.

In the name of reform, however, the acrimonious debate over student loans has raged on with the allegorical pitting of the "profiteering middlemen" of the banking industry against the "entrenched bureaucrats" of the government. It has been difficult to sort out the fact from the fiction, the truth from the hype, the costs from the savings; and the current political climate has only intensified competing ideologies. As a financial aid director, I believe that *student need* is the overarching umbrella under which all other issues should fall in this debate.

When it became apparent that the financial needs of our nation's college students were not being adequately addressed under the Federal Family Education Loan Programs (FFELP loans were called "guaranteed student loans" in years gone by), reform became the rallying cry. There are many ways to reform student loans. One of them--a government-based solution--is the Federal Direct Student Loan Program.

The Direct Loan program was based on the solid notion of eliminating the complexities of borrowing for college. Dedicated financial aid people, colleagues I respect enormously, set about to create a program that worked for students and for schools. Direct Loans resulted from this vision. I might add that the lack of responsiveness by many of the players in the Federal Family Education Loan Programs--the banks, the regulators, the secondary markets, the guaranty agencies, collection entities, and the like--provided much of the impetus for Direct Loans as well.

Direct Loans, from all appearances, have resolved many of the front-end problems that have plagued the FFELP. The Department of Education has demonstrated an unparalleled level of support to the program and has committed the resources necessary to make it work for the participating schools. This has been good for students and good for schools. However, Direct Loans are not the only method by which borrowing can be simplified and improved with similar benefits.

Because of Direct Loans, the lending community "sat up and took notice." Fueled, in part, by the very competition posed by direct government lending programs, lenders have become far more sensitive to the demands of the market place and are trying to meet the needs of students and schools in new and creative ways. For some of us, the option of having Federal Family Education Loans financed through banks and other financial institutions remains an attractive one. For example, the private sector is able to offer repayment incentives not available through Direct Lending. I am glad that educational institutions still have a choice on financing options to offer students.

My campus had the option of participating in the Direct Loan Program in its second year and we are still on the list of year three schools. Because we were in the throes of recovering from the massive damages of the Northridge earthquake, moving to a completely new system of student borrowing through Direct Loans did not seem feasible and we elected not to participate. However, using the established loan system and including loans in a student's financial aid award "package" in the same way that Direct Loans were processed *was* feasible. With the help of the lending community and ELM Resources (Education Loan Management), we opted to remain in the FFELP program and work toward the improvement of its delivery at my campus. This has worked extremely well for us.

Like many campuses, we formerly used a completely separate processing cycle for the "regular" financial aid programs--Perkins loans, Work Study, and Federal Grants--and then we processed the "bank loans." It became apparent that this kind of bifurcated processing was not only detrimental to departmental efficiency, but it posed enormous impediments to the timely delivery of actual dollars to students. Other impediments were imposed by burdensome regulatory requirements and the cumbersome nature of the loan process itself. Loan processing is now done in a dramatically different way at my campus and I hope that it will be possible in the near future to make even more dramatic changes to the way in which my students can apply for aid, be evaluated for eligibility, and be funded.

At Northridge, we have gone from a completely paper loan processing environment to one which is nearly paper-free. While we will not be able to move into a completely electronic environment--from the application for aid through direct deposit into student bank accounts--we now process our 7,000 annual student loan volume very differently than we did in the past. I have been grateful for support that ELM has extended and appreciate the effort to continue to find ways to improve our process. I believe that our best chance for success in that regard is to take advantage of innovations offered by private enterprise in partnership with the public sector. ELM and other entities like it, continue to work to make such innovations a reality.

The full implementation of the ELM project as originally envisioned would address many of the front-end needs for students and schools in application processing. I would like to use a customized computer disk or an on-line application protocol for my incoming first-time freshmen application processing. I could tailor this to fit my unique institutional needs and still incorporate the mandatory data elements required by the Department of Education in its Free Application for Federal Student Aid (FAFSA) form.

The Department of Education has made it clear that the only allowable application form for student aid programs is the paper FAFSA form which they have approved. Electronic applications would greatly simplify processing. ELM has developed such an "application of the future" on a computer disk, but it is not an "allowable" form according to current statute and cannot be put into use. The Department of Education is developing similar technology although it has not been released. I hope that efforts in this area--from some sector--public, private, or from an entrepreneurial partnership of the two--will bear fruit soon.

We have an obligation to keep pace with the technologies that our student consumers have come to demand and that we can offer--now--innovations in the way in which students apply for aid and the way in which we move and validate required data. Enormous efficiencies can be realized through the technological innovations offered by private enterprise. There are still regulatory impediments to such innovations. In the interim, and absent a change in the law on electronic application means, FFELP loans must continue the paper application process and generate separate loan application requests.

There is "good news," however, in other aspects on the loan processing front. Our new FFELP process represents an enormous improvement in processing steps and time-to-delivery of aid. The processing system relies on ELM as a service bureau for loan application processing. My students can stay with the banks with which they have done prior student loan business. I like the fact that my students borrow from lending institutions and that they establish a banking relationship in this way. Lenders come to my campus and assist with the counseling of borrowers on credit obligations and repayment information. The student borrower relationship with the lender is something that I view as positive. It teaches a borrower about borrowing.

From an administrative standpoint, however, the multiplicity of lenders had been problematic. Here is where ELM Resources has made some wonderful innovations and greatly simplified the student loan process through standardization. From the school perspective, the ELM system makes the lenders nearly "transparent" to me. I deal with one primary entity: the ELM service bureau. The overwhelming majority of my student borrowers are currently dealing with lenders who are in the ELM group. However, even for those who borrow outside the ELM group, the processing can be greatly automated and standardized.

The application data--with the borrower's lender of choice--is electronically shipped from my school to our service bureau which transmits to the lender and guaranty agency. The promissory note process remains within the purview of the lender--not the school. This appeals to me. Although there are no *significant* school liability issues presented in the Direct Loan promissory note process, there are *none* in the FFELP program. Additionally, we can track the complete progress of the loan through the ELM loan status system and the loan process is fully integrated with all other Title IV financial aid processing.

The creation of student loan checks is folded into our other aid processing which permits the necessary unit-load checking, holding of checks for other compliance-related reasons, and the use of funds--upon student request--to pay for their educationally-related expenses. A central disbursement agent processes all loan proceeds via electronic funds transfer to our student accounting system and handles all cancellation, refund, and reconciliation activities with the lenders. From the school perspective, this is a greatly simplified FFELP process and has made student loan processing a very different animal than it was a few years ago. I believe it is only the beginning on what can be done to improve student loan delivery.

Some would argue that the Department of Education is the best entity for making student loans and that it should be readied to handle all of the nation's student loan volume. Others hold the view that the FFELP is so structurally flawed that it has to be scrapped. Perhaps neither position should be absolute. I have seen problems in the student loan program and I have also seen thoughtful and collaborative solutions being offered. I believe that competition in student lending is a good thing and the result has been a greatly improved level of service, responsiveness, and accountability from both the public and private student loan makers. A continuation of this innovative spirit can only serve to improve student loans overall.

To conclude, what we are doing at Northridge can be accomplished at other campuses with a desire to simplify their FFELP processing. The ELM project has folded the processing of those "bank loans" completely into the routine processing of our Title IV and other institutional aid programs with the same kind of simplicity envisioned by Direct Lending. Although there has been a decided change in the method of doing business, it has left the "business" intact with no disruption to my student borrowers. And it has brought me the best of what the lending community can do when it combines forces to offer a new initiative: a student loan product that is being developed and delivered according to the needs of my department and the students I serve.

Finally, if I find that I am not happy with the service of ELM, or if they do not stay competitive and responsive to my needs, I have the option of terminating my relationship with that service bureau and seeking better alternatives for my students. I like having a choice and keeping my options open.

Thank you.

Chairman HOEKSTRA. Ms. Fawthrop.

STATEMENT OF LYNN FAWTHROP, DIRECTOR OF FINANCIAL AID, ROGER WILLIAMS COLLEGE

Ms. FAWTHROP. Thank you, Congressman Hoekstra and Members of the subcommittee for this opportunity to share our committee's observations on the operation of the Ford Federal Direct Loan Program.

Our committee was created by Congress in the Higher Education Act of 1986 to provide an independent source of advice and counsel to Congress and the Secretary. Our most recent focus results from the Education amendments of 1992 when Congress asked our committee to study simplifying the Federal Family Education Loan Program.

In 1993 OBRA conferees directed our committee to monitor and evaluate implementation of direct loans and the effects of modifications in FFEL as well. We have monitored the programs for over 21 months and submitted a report to Congress last August. Since then, we have held hearings on both programs.

I'd like to preface my remarks about the operation of direct loans with a broad observation about the loan programs in general. Our committee believes that either loan program, FFEL or direct loans, or a well structured hybrid can serve students and institutions well if it is properly designed and managed. We have not, and will not, take a position on which program should prevail or whether both should.

The key issue for our committee is making either or both programs work. By that, I mean ensuring that they meet the needs of students and institutions, while maintaining integrity and accountability.

Let me share some personal experiences with you. My institution, Roger Williams University, is a direct lending school. I must tell you that the direct loan program has worked relatively well at Roger Williams. There have been operational glitches, to be sure, primarily relating to software and systems. However, the direct loan program solves problems for me and my students that the current FFEL program does not.

Indeed, we chose to participate in direct loans partly because we had lost patience that the FFEL program could resolve longstanding problems of complexity and burden.

An Advisory Committee report to Congress in April 1993 documented the problems of complexities and inefficiencies in FFEL. My experience with the direct loan program at Roger Williams University mirrors that of our committee, that our committee has found in our loan evaluation study at the majority of participating schools.

As we stated in our letter to Senator Jeffords, direct lending is a feasible program with many desirable features for both students and institutions. Program operation in the first year was relatively smooth up to reconciliation, and the Department has shown the ability to manage the new program.

Having said that, I must add that our study found several operational problems that might be associated with the start-up of the new program. Most involved system and software problems. They are not fatal, by any means, and can be addressed through proper management. Two problems, however, merit attention.

First, because of the decision by direct lending managers to allow institutions flexibility in reporting, it is not possible to prevent multiple loans, tie cash drawdowns to actual disbursement data, or to easily reconcile institutional accounts in a timely manner.

While the Department of Education has announced plans to address these problems in the long run system development effort, our committee is concerned that there is no short run contingency plan, if this long run effort stalls or perhaps fails, as occurs so often in both private and public sector.

Second, it appears that a large number of schools with questionable default records or unreliable data will be allowed to participate in year two. Our committee felt this was an unfortunate decision that gained the program little, if anything. Our point is not that high default schools which are eligible to participate in FFEL should be excluded from direct lending. The issue is that direct lending has an income contingent repayment option that might be used by problem schools to hide lack of quality in educational programming.

In our judgment, the Department of Education has not thought through how such schools would be tracked and how their performance would be measured if large numbers of their students were encouraged to choose income contingent repayment option. Finally, let me say, even with regard to these two issues, the Department of Education can take the initiative and move quickly to minimize the problems.

I want to close by stating that the operational problems in the first year of direct lending must be judged against a backdrop of an overly complex and inefficient FFEL program, and that little would be gained if start-up problems in direct loans are used as a justification for limiting the direct loan program without addressing major problems in FFEL.

Once again, I thank you for the opportunity to testify, and I'll be happy to answer any questions.

Chairman HOEKSTRA. Thank you.

[The prepared statement of Ms. Fawthrop follows:]

LYNN M. FAWTHROP, CHAIRPERSON

ADVISORY COMMITTEE ON STUDENT FINANCIAL ASSISTANCE

Thank you, Mr. Chairman, and members of the Subcommittee for this opportunity to share our Committee's observations on the administration of the Ford Federal Direct Loan Program (FDLP). My name is Lynn Fawthrop, Director of Financial Aid at Roger Williams University in Bristol, Rhode Island. I am representing the Advisory Committee on Student Financial Assistance, of which I have been Chairperson since January 1993. The Advisory Committee was created by Congress in the Higher Education Amendments of 1986, to provide an independent source of advice and counsel to both the Congress and the Secretary of Education on student aid policy.

Congress originally defined its purpose in statute: to provide extensive knowledge and understanding of federal, state, and institutional programs of postsecondary student assistance; to provide technical expertise with regard to systems of need analysis and application forms; and to make recommendations that will result in maintenance of access to postsecondary education for low- and middle-income students. The Advisory Committee's structure reflects the diversity of the contemporary financial aid community. College presidents, financial aid administrators, educational association executives, bank officers, guaranty agency executives, state higher education officials, and students have served on the Committee. Members are appointed by the leaders of the United States Senate, the House of Representatives, and the Secretary of Education on the basis of technical expertise and knowledge of student aid and educational policy. The eleven members serve in staggered terms of three years.

Our focus over the last three years results from the Education Amendments of 1992 when Congress required our Committee to study simplifying the Federal Family Education Loan Program (FFELP). In the attached April 1993 report to the Congress, entitled "Student Loan Program Simplification: Interim Recommendations," the Committee recommended radical restructuring of the FFELP to overcome what our Committee found to be unacceptable complexity and inefficiency in that program. The Committee identified six sources of complexity, including:

- Multiple, overlapping loan programs exist, none of which have sufficient annual limits to discourage multiple program borrowing.
- Terms and conditions conflict among the loan programs.
- The programs operate under burdensome legislative and regulatory requirements, most of which have been created to control program costs and default rates.
- Lender and guarantor policies are inconsistent.
- Loan processes and forms are not standard.
- The existing data and network infrastructure is insufficient.

Broad agreement existed in the higher education and loan community for addressing these serious flaws in the program. The Committee recommended several steps to address this complexity:

- streamlining and standardizing the loan programs;
- reducing the number of loan programs;

- reducing the number of agencies and lenders;
- providing borrower refinancing options;
- using the FAFSA as the loan application; and
- integrating FFELP delivery into the broader Title IV delivery system.

In response to a request from Senator Pell, we also included in our July 1993 final report a complete set of recommendations on how a direct loan program should be structured, since Congress was considering full-scale implementation of direct lending at that time. Congress implemented most of the Committee's FDLP recommendations. However, most recommendations for the FFELP, perhaps the most difficult, have not been addressed.

In August 1993, OBRA conferees also directed our Committee to advise the Congress and Secretary on both the implementation of the FDLP and the effects of modifications in the FFELP as well. We have monitored both programs for over 21 months, held a direct lending hearing in November 1994 and an FFELP hearing in April 1995. The Committee's first annual evaluation report, "Implementation of the Federal Direct Student Loan Program and Modification to the Federal Family Education Loan Program," submitted in August 1994 is attached.

I mention this brief history today for two reasons. First, since 1992, the Congress has looked to our Committee for advice on student loan programs generally and, accordingly it has been one of our highest priorities. Second, we want the Subcommittee to understand the full context in which our comments will be made today.

Either the FFELP or FDLP can serve students and institutions well if they are properly designed and operated. And, both programs can be improved dramatically by elimination of structural deficiencies in the overall system that delivers student aid.

Our Committee will deliver a full report late this summer that will reiterate and update the changes in both programs that are required for each to serve students and institutions well. Our Committee has not and will not take a position on which program should prevail--or whether both should. However, as in the past, we will continue to recommend those changes that are required to ensure efficiency and integrity in either, both or a hybrid if that is the decision of Congress.

Having provided those introductory remarks, let me now turn to the issues to be addressed today. About two months ago, on March 17, 1995, our Committee responded to a request from Senators Jeffords and Kassebaum in preparation for a hearing. Their question concerned issues of accountability and quality in the FDLP. Let me summarize the points in our response which we are submitting today as part of the written record. In addition, we provided brief observations concerning the overall operation of the FDLP.

OVERALL ASSESSMENT

I would like to provide three observations with regard to our assessment of the FDLP to date based in part on feedback from institutions that testified at the Committee's November hearing:

- First, our loan study to date has found the FDLP to be a feasible program with desirable advantages to institutions and students.
- Second, implementation and program operation have been relatively smooth up to reconciliation.
- Third, the Department of Education (ED) in general has shown both the ability and commitment to manage the program.

I can attest personally to each of these because my institution, Roger Williams, is a direct lending institution. Having stated that, however, it is the Committee's perception that there are important shortcomings that need to be addressed to ensure efficiency, accountability, and integrity. Our March 17 letter to Senators Jeffords and Kassebaum contains specific recommendations in each of these areas and is part of our written testimony.

ADMINISTRATIVE ACCOUNTABILITY

In the area of institutional accountability, the student aid delivery system as it exists today cannot support critical functions for maintaining program-by-program accountability, quality and integrity. This structural deficiency affects all programs, not just FDLP.

In a letter to Secretary Riley on June 15, 1994, (attached), our Committee noted that the student aid delivery system could not prevent multiple awards, tie cash drawdown to data in the system, or reconcile accounts adequately. These are all functions taken for granted in most large data processing and financial systems. We recommended in that letter that ED move quickly to revise the Central Processing System (CPS) Request For Proposal (RFP) to eliminate this deficiency. This contract provided a unique opportunity to make interim changes that could address key shortcomings virtually immediately, rather than awaiting full system redesign, requiring three to five years. However, on August 18, 1994, we received a response from Leo Kornfeld, Deputy Assistant Secretary, stating that since the CPS recompetion had no bearing on these issues, no changes would be made to the RFP. Failure to make interim changes to the CPS RFP and complete the necessary system modifications means that ED must either use costly task orders and contract charge order vehicles to address these problems in the short run or wait years for broader system changes in the nearly dozen systems and databases currently making up the Title IV delivery system.

We further noted this deficiency in a letter to Congressman Goodling on October 31, 1994, and its negative effect on FDLP. In that letter, we recommended that ED encourage institutions to report disbursements early--a step that would not only minimize the potential for multiple loans but would have also avoided most of the well-known problems encountered in reconciliation this year. This recommendation also went unheeded.

In addition to this structural deficiency in delivery and failure to encourage institutions to report early, in the first year of FDLP implementation there have been problems in software and systems design that have made reconciliation in FDLP an unnecessarily slow and difficult process. We are prepared to discuss how structural deficiencies in delivery and these factors interact, if you should decide to do so.

INSTITUTIONAL QUALITY

In the area of institutional quality, it appears that a number of institutions that will participate in FDLP this year have either very high default rate histories or no history at all. The exact numbers have been provided in our March 17 letter to Senator Jeffords and Kassebaum. I especially want to stress one point: our estimates did not include institutions that are exempted by statute from default rate triggers.

The inclusion of some high default schools would not be a major problem. However, our Committee is not aware of the development of measures of institutional quality in FDLP that serve the same functions as default rate measures in FFELP. This is especially troubling in the face of announced plans to use income contingent repayment (ICR) to reduce defaults and the apparent lack of any plans to monitor high default schools' performances in FDLP.

With regard to our preliminary findings on both reconciliation and institutional selection, I must state that it has been extraordinarily difficult to get information from ED. Several requests have gone completely unheeded.

SUMMARY

The Advisory Committee urges Members to focus on improvements necessary in both loan programs. The FDLP has been remarkably successful in its first months of operation in spite of the problems identified above. The FDLP institutional origination process has eliminated some of the most daunting problems with the FFELP that the Committee identified in the Loan Simplification Study. Yet, improvements in ED management of the program and FDLP systems and operations are clearly required.

Congress initiated important changes and the loan industry has made impressive efforts to reform the FFELP, which has resulted in service improvements for students and institutions. However, the agenda for structural reform outlined in the Committee's 1993 Loan Simplification Report remains to be fulfilled and some of the most difficult and divisive problems must be confronted. Significant efforts are required to address the needs of students and institutions in that program.

Advisory Committee on Student Financial Assistance

June 15, 1994

The Honorable Richard W. Riley
Secretary
U.S. Department of Education
400 Maryland Avenue, S.W.
Washington, D.C. 20202-0100

Dear Mr. Secretary:

I am writing on behalf of each of our members about a matter of great importance to the Department of Education (ED), the Congress, and the entire postsecondary education community. A singular opportunity exists to use upcoming procurements to restructure the systems that deliver Title IV student aid--to make them more efficient and ensure program integrity. The benefits to all parties are truly substantial and can be achieved without a significant increase in the costs of delivering federal funds to needy students. However, it appears that this opportunity may be squandered in a headlong rush to recompete existing contracts. We are recommending that you direct ED staff to carefully reconsider the long-run implications of their procurement strategy.

ED has issued draft requests for proposals (RFPs) for major contracts that support application, processing, and disbursement of Title IV funds. The structure of these RFPs will determine the capabilities and shortcomings of the student aid delivery system into the next century. Relatively modest modifications in these RFPs and resulting contracts can produce dramatic improvements in performance, efficiency, integrity, and cash management. Unfortunately, our initial assessment suggests that these systems will remain essentially unchanged for the rest of the decade.

In 1986, Congress charged the Advisory Committee to monitor delivery on an ongoing basis and make recommendations for improvement. We have just completed a year-long study of the systems and processes involved and have identified serious deficiencies. These were shared with ED staff in April of this year. A copy is enclosed.

Great progress has been made in the program and policy areas over the last few years. The vast majority of students now complete only one data set on only one form and are means tested under only one model. In contrast, the delivery system itself is a puzzling assortment of dozens of separate data bases, contractors and facilities, most of which do not communicate with each other. This, for example, forces institutions to report awards for the same student to several different entities at different times and on different schedules.

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Indeed, the structure of delivery is so fragmented that it leads to embarrassing lapses in function and associated shortfalls in efficiency and integrity. Particularly troublesome is that, even after the award of thousands of dollars, the central data base does not know where the student is enrolled and, accordingly, can't warn another school not to award the same student for the same period. Further, the system cannot send an institution's computer generated reapplications to the institution because it doesn't know which students are there. Instead, it must employ a costly method of mass mailing that requires extensive follow up. Lastly, and perhaps most important, the system cannot link draw down and expenditure of federal funds with valid, current eligibility data or reconcile accounts accurately at the end of the award year.

Like the systems of most federal agencies, ED's Title IV delivery system has been developed over time, sequentially, as new programs and functions have emerged. In each instance ED staff have done their best to modify and improve at the margin. Until now there has not been the opportunity to step back and examine the entire structure.

Given the intense and increasing scrutiny directed at the programs by the Inspector General, General Accounting Office, and powerful committees in Congress, the opportunity to reassess and change direction comes none too soon.

However, to date, the plans that ED has shared with the community and our Committee including those presented at a formal hearing on June 6 fail to address the most important of these deficiencies. Since release of the central processing system (CPS) procurement--perhaps the most important of the delivery system components--is imminent, we are recommending that you direct your staff to give immediate attention to the issues involved before the final RFP is released.

To ensure system-wide efficiency and integrity, ED must formulate a comprehensive plan that addresses these deficiencies over the next five to seven years. This plan must include modifications in the specifications of each of its systems and contracts so that an orderly large scale system enhancement process can begin early in 1995. The cornerstone of the plan must be a new data architecture, including a comprehensive Title IV-wide data base that integrates all processing, monitoring, reporting, and cash management functions.

We feel there is sufficient time to address these issues through revisions to RFPs in the final planning phases. The process of reviewing and commenting on draft RFPs provides a fortuitous opportunity to incorporate essential changes. If ED staff believe it is too late to make the required changes, then we recommend extending contracts perhaps for one year--not rolling them over for five to seven years with unchanged specifications.

In the meantime, if the Committee staff can be of any assistance, please call our Staff Director, Brian Fitzgerald. Thank you for your attention to these important issues.

Sincerely,

Lynn M. Fawthrop

Lynn M. Fawthrop
Chairperson

Enclosure

cc: Advisory Committee members
The Honorable Madeleine Kunin
The Honorable Marshall Smith
The Honorable David Longanecker
Mr. Leo Kornfeld
Ms. Maureen McLaughlin
Mr. William Moran
The Honorable William Ford
The Honorable Pat Williams
The Honorable Thomas Sawyer
The Honorable Jolene Unsoeld
The Honorable Patsy Mink
The Honorable Robert Andrews
The Honorable John Reed
The Honorable Tim Roemer
The Honorable Dale Kildee
The Honorable Robert Scott
The Honorable Ron Klink
The Honorable Karan English
The Honorable Ted Strickland
The Honorable Xavier Becerra
The Honorable Gene Green
The Honorable Thomas Petri
The Honorable Steve Gunderson
The Honorable Randy Cunningham
The Honorable Dan Miller
The Honorable Paul Henry
The Honorable Marge Roukema
The Honorable Peter Hoekstra
The Honorable Howard McKeon
The Honorable Richard Armey
The Honorable Claiborne Pell
The Honorable Howard Metzenbaum
The Honorable Christopher Dodd
The Honorable Paul Simon
The Honorable Barbara Mikulski
The Honorable Jeff Bingaman
The Honorable Edward Kennedy
The Honorable Paul Wellstone
The Honorable Harris Wofford
The Honorable Tom Harkin
The Honorable James Jeffords
The Honorable Nancy Kassebaum
The Honorable Dan Coats
The Honorable Judd Gregg
The Honorable Strom Thurmond
The Honorable Orrin Hatch
The Honorable Dave Durenberger

ATTACHMENT

DEFICIENCIES IN THE CURRENT TITLE IV DELIVERY SYSTEM

- Basic information is not available in time to prevent multiple awards for the same period at different institutions.

- Necessary certifications are not automatically provided, requiring instead, extensive manual, paper-based processes at the institution increasing the potential for institutional liability.

- Records cannot be submitted for rematching when ED's systems cannot conduct matches with other data bases (e.g., social security), increasing burden and the potential for institutional liability.

- Reapplications cannot be sent to the institution at its request for distribution to its students, rather than mass mailing reapplications to its students, requiring burdensome and costly mailings by institutions to returning students.

- Communication is not possible with institutions or sending of rosters of reapplicants who should have, but mistakenly did not, release data to the institutions, requiring mass mailings by institutions.

- Institutions cannot send completed reapplications for keying to the MDE.

- Institutions cannot draw down selected student records at key times without drawing all records down, increasing burden.

- Flexible timetables for reapplications cannot be provided.

- Differentiation is not possible among students attending several branch campuses or different programs within the same school using a common institutional code.

- Integrated reporting of student awards in all Title IV programs through a single reporting mechanism is not possible.

- Integrated monitoring and cash management are not possible across all Title IV programs--draw down of funds cannot be tied to valid current eligibility and award data and accounts cannot be reconciled accurately.

Advisory Committee on Student Financial Assistance

October 31, 1994

The Honorable William F. Goodling
Committee on Education and Labor
U.S. House of Representatives
2263 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Goodling:

Thank you for reading and responding to our August report on the student loan programs. We are very happy the report was informative and beneficial to your oversight of the implementation of the Federal Direct Student Loan Program (FDSLP).

In your letter you asked for our Committee's reaction to four questions:

- Should the disbursement rules we recommended for the FDSLP also be used in the Federal Family Education Loan Program (FFELP)?
- Is the Committee satisfied that the Department is taking the necessary steps with respect to Title IV system design and potential integrity problems?
- What can the Department do in the short run while it redesigns its Title IV system?
- Does the Committee feel that the Department's use of Sallie Mae to ensure access to loans is adequate?

With regard to disbursement rules, your suggestion that if a rule is complex in FDSL it is also complex in FFEL is well taken. It certainly makes sense to evaluate such a change in FFEL. The rationale for our recommendations to the Secretary, delivered after legislative changes had been made, was that the Department had not implemented fully what Congress had made clear in statute--that disbursements in FDSL be consistent with Pell Grants. However, Congress made no such change in FFEL. Accordingly, our Committee made no recommendations about implementation to the Secretary in this regard.

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As noted in your letter, our report to Congress and the Secretary identified several system design and potential integrity problems across the Title IV programs. We are satisfied that the Department recognizes these problems and is taking steps that it feels will ensure program integrity. The Department's strategy consists of four basic components:

- a complete requirements analysis identifying key functions and processes in the new delivery system;
- procurement of a hardware platform to which separate Title IV data bases can be migrated and integrated;
- building of a new school-based management system to tighten cash management and control of funds drawdown; and
- expansion of NSLDS to become a Title IV-wide recipient data base.

Each of these interrelated tasks is a significant undertaking. Even with the best planning and coordination, the Department's own estimates suggest at least three and perhaps five years until significant improvements are realized. The entire approach, however, depends upon the timely enhancement of NSLDS, the centerpiece of the Department's strategy, a system which has already experienced significant delays.

With regard to your concern about the integrity of the FDSLP until the new system is operational, our Committee's August report suggested that the Department improve the current direct loan operating system in two ways. To avoid exceeding annual loan limits, we proposed that the system capture and edit dependency status and ensure that institutional software include sufficient edits to track loan amounts. To prevent multiple loan awards, we recommended that institutions report planned disbursements early enough to prevent multiple awards.

It is our understanding that the Department recognizes both problems. Regarding the potential for exceeding annual loan limits, the Department has notified its contractor to make the required edit changes in the system and software for 1995-96. Regarding the potential for multiple loans, the Committee is unaware of any current plans to change institutional reporting or system edits that will minimize problems.

Your last question focused on the adequacy of the Department's use of Sallie Mae to ensure access to loans for all eligible students. Our preliminary assessment is that the approach is adequate and we are not aware at this time of any potential problems with access.

Once again, thank you for your continuing commitment and efforts to improve Title IV student aid. Please let our Staff Director, Brian Fitzgerald, know if we can be of further assistance.

Sincerely,

Lynn M. Fawthrop

Lynn M. Fawthrop
Chairperson

cc: Advisory Committee members
The Honorable Richard W. Riley
The Honorable Madeleine Kunin
The Honorable Marshall Smith
Mr. Leo Kornfeld
The Honorable David A. Longanecker
Subcommittee on Postsecondary Education and Training
Subcommittee on Education, Arts, and the Humanities

Advisory Committee on Student Financial Assistance

March 17, 1995

The Honorable James M. Jeffords
Committee on Labor and Human Resources
United States Senate
513 Senate Hart Office Building
Washington, D.C. 20510

Dear Senator Jeffords:

Thank you for the opportunity to provide observations and suggestions regarding integrity in the Ford Federal Direct Loan Program (FDLP). As you know, our Committee has been evaluating the implementation of the FDLP in accordance with a mandate from Congress. Our study, now in its second year, includes the Federal Family Education Loan Program (FFELP) as well, and will produce a second report this summer on all aspects of program implementation.

The program integrity issues discussed in your letter are important ones that have two key dimensions: program accountability and institutional quality. With regard to program accountability, the problems encountered in FDLP reconciliation in the first year are a symptom of broader challenges facing all Title IV programs. With regard to institutional quality, the lack of appropriate measures--specifically an equivalent to the cohort default rate currently used in the FFELP--signals a need for a much closer look at how quality can be ensured in the new program. In both areas, the problems can be addressed by proper corrective actions by Department of Education (ED) managers in charge of student aid delivery and the FDLP.

The remainder of this letter discusses the issues of program accountability and institutional quality raised in your letter by identifying the underlying causes of the problems and making recommendations to remedy them. In order to establish the context in which our findings are presented, several caveats are in order.

- The Advisory Committee's study to-date has found the FDLP to be a feasible loan program with important, desirable features for institutions and students. These include integrated delivery, institutional origination, and income contingent repayment.
- Implementation of the program has progressed well and program operation has been quite smooth through loan origination and disbursement.

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- ED has shown clearly that it has the ability and commitment to manage the FDLP effectively.

However, even though the FDLP has been shown thus far to be feasible, desirable to institutions and students in its operation, and manageable by ED, your letter is correct in its assumption that important shortcomings do exist that will threaten accountability and quality if not addressed in a timely manner.

PROGRAM ACCOUNTABILITY

The Committee has identified problems in the FDLP reconciliation process, which is designed to ensure that the loan records and the cash management data in the FDLP servicer and the institutional systems match precisely. Similar problems have been observed by ED's Office of Inspector General (OIG) and are reflected in ED's Dear Colleague Letter concerning reconciliation. Our Committee believes that there are four causes of the problems.

- *Structural deficiencies* in the overall delivery system for student aid adversely affect all Title IV programs--including FDLP loans. These deficiencies were highlighted most succinctly in a letter from our Committee to Secretary Riley on June 15, 1994.

- *Short-run policy decisions* by ED managers, necessitated by these structural deficiencies, have exposed the program not only to inefficiency but potential program integrity problems. The Advisory Committee addressed these issues in both our August 1994 report to Congress on the loan programs and in a letter to Congressman Goodling on October 31, 1994.

- *Software problems* have hampered program operations from the outset. The Advisory Committee was able to explore the scope of the problems with ED-supplied software with 18 institutions at its hearing in California last November.

- *Design shortcomings* in the FDLP servicer system have prevented smooth operation in *back-end* processes, including reconciliation. These problems were documented and discussed at the same hearing.

In order to fully appreciate the problems of reconciliation--and their solution--it is necessary to review the contribution of each of these factors.

First, *structural deficiencies* in the student aid delivery system result from the lack of a fully functional Title IV-wide recipient database that can integrate all program operations. The problems that result continue to haunt the Title IV programs, including the FDLP and the FFELP. For example, the current delivery system cannot identify where the student is enrolled, even after the award and disbursement of thousands of dollars in student aid. Furthermore, it neither prevents multiple awards, nor can it tie institutional cash drawdown to data already in the applicant system at the *front end*, i.e., up to origination. If a Title IV-wide recipient database were operational, it could provide a *front-end* capability to perform these functions. Much of the reconciliation problem in the FDLP referred to in your letter, and certainly all of the implications for program integrity, would consequently disappear. The OIG has also recognized that ED's automated systems are unable to generate accurate, timely data and favors controls at the *front end*.

The Committee recommended in its June 15, 1994 letter to Secretary Riley that ED address this longer-run problem by modifying the specifications for each system and processing contract in the series of contracts that deliver these programs. Indeed, in response to our recommendations, a meeting called by the Senate staff on July 12, 1994, was held to discuss how ED would address the Advisory Committee's concerns. At that meeting, ED officials promised Senate staff that a complete review of systems procurements would be undertaken to identify how each contract and subsystem needed to be modified to move toward an integrated Title IV-wide delivery system and database over the next three to five years. ED's review was to begin last year with the most important of the *front-end* system components--the central processing system (CPS), which contains applicant data for almost 10 million students. Unfortunately, the CPS request for proposal (RFP), released on December 7, 1994, shows no sign that *front-end* system modifications are planned to prevent multiple awards or tie cash drawdown more closely to the applicant database for each institution. Rather, ED appears to be taking a long-run approach without a parallel contingency plan to ensure integrity in the meantime.

Because *front-end* system enhancements have not been made, ED is forced to rely on *back-end* processes, which occur after award and disbursement of funds, to ensure against multiple awards and excessive or premature cash drawdown by institutions. However, relying on *back-end* institutional reporting, such as reconciliation, as the mechanism to minimize problems that should be eliminated on the *front end*--before drawdown and disbursement--requires a trade-off. *Back-end* reporting necessitates more stringent requirements to preserve full accountability for the expenditure of federal funds and, thus, places more burden on institutions. This burden is exacerbated by problems with software and servicer systems as described on the following pages.

Second, ***short-run policy decisions*** have contributed significantly to the problems encountered in reconciliation. To exempt institutions from *back-end* reporting, ED decided against a recommendation made by the Advisory Committee in its August 1994 report to Congress that institutions be motivated to report early in the process. Instead, ED designed FDLP functions to allow most institutions considerable latitude when--relative to funds drawdown--they report or submit originations, promissory notes, and disbursements to the FDLP servicer. For example, institutions may drawdown funds before reporting any data. Furthermore, institutions have delayed reporting disbursements of funds to borrowers for as many as 60 days or more after the disbursements are made. While well-intentioned, this policy contributed greatly to delays in reporting and resulted in a significant gap between drawdown and reported disbursements, and complications in reconciliation.

The policy decision to allow institutions flexibility in reporting makes preventing multiple loans and tying drawdowns to disbursements impossible in a system without a fully functional, student-level database. Even if the FDLP servicer is directed to match loan records across institutions at the *back end*, a procedure not currently in place, ED's policy of permitting institutional flexibility in reporting makes it impossible to identify multiple loans *before* disbursement occurs. Finally, although the Advisory Committee is not aware of first-year FDLP institutions taking improper advantage of this flexibility, such as maintaining excess cash, the processes currently in place are open to misuse because the origination, drawdown, and disbursement processes are not sufficiently integrated in spite of current Title IV cash management and FDLP regulations.

Third, ***software problems*** have compounded difficulties resulting from structural deficiencies and policy decisions by making the physical task of reconciling accounts much more difficult. Institutions have reported to the Advisory Committee that ED-supplied software is subject to slow data processing, systems crashes, and corrupted data. These problems have delayed or prevented schools from reconciling on schedule, an ability which is taken for granted in most large private data processing systems.

Fourth, ***design shortcomings*** in the FDLP servicer system have further intensified problems in conducting reconciliation. The most important of these is the loan-specific character of the FDLP servicer system, a shortcoming also reflected in ED-supplied institutional software. Institutions generally manage information on a student-specific basis. This design flaw increases dramatically the burden of performing even routine functions and the difficulty of conducting reconciliation successfully. In addition, other problems with system interfaces between the institution and the FDLP servicer have made the reconciliation process extremely tedious for institutions. Examples include rigid accounting protocols and mismatches between software and servicer edits.

All four factors--structural deficiencies in delivery, short-run policy decisions, software problems, and design shortcomings--have contributed to reconciliation delays and difficulties in the first year. In order to ensure program integrity in the future, ED must address each of these problems in a systematic manner. To ensure these problems are solved as soon as possible, the Committee is recommending that ED take several short- and long-term actions.

- Reverse previous policy decisions and modify the CPS to prevent multiple awards across programs and tie drawdown of funds to Title IV program disbursements, including disbursements of FDLP loans. This enhancement can be performed under the task order component of the new CPS contract. Conceivably, this new function could be installed in time for the 1997-1998 award year.

- Review the policy of allowing FDLP institutions wide latitude in reporting disbursements to the servicer, and move expeditiously toward more closely integrating origination, drawdown, disbursement, and reconciliation.
- Produce a reporting system that identifies quantitative targets for the second year of FDLP program operations and system performance that will allow real-time measurement of multiple awards, excess cash, and gaps between disbursement and reconciliation.
- Provide for an external evaluation of all ED-supplied institutional software used in the program and consider the need for a complete, parallel software redesign that can be installed in the third year of the FDLP program.
- Conduct an external systems review, including the database structure, aimed at eliminating design shortcomings such as the loan-specific nature of interfaces between institutions and the servicer. This should be completed in time for the third year of FDLP operations.

It is extremely important that the reconciliation problem not be viewed as a narrow, short-term problem. Once again, it is a manifestation of Title IV-wide systemic problems that must be addressed through a broad set of management corrective actions to ensure long-run program integrity.

INSTITUTIONAL QUALITY

The second question in your letter relates to concerns over the lack of a measure of institutional quality in the FDLP equivalent to FFELP cohort default rate determinations and the long-term consequences for program integrity. In response to your request, the Advisory Committee has conducted a preliminary analysis that includes an examination of the default histories of FDLP institutions. Our analysis has identified four problems.

- The *selection process* for allowing institutions to participate in the FDLP appears to have permitted institutions with questionable performance records to enter the program.
- Current *selection criteria* appear to be inadequate to prevent problems related to program integrity in the future.

- There appears to be no plan to ***monitor institutional quality*** to detect mismanagement by high default institutions.

- ED has not developed ***measures of institutional quality*** required to ensure program integrity, comparable to the cohort default rate in the FFELP.

Each of these problems requires immediate attention to ensure institutional quality in the FDLP.

First, ED's ***selection process*** allows institutions with questionable records to participate in the FDLP for 1995-96. Exclusive of institutions eligible for cohort default waivers:

- 272 schools have default rates of 25 percent or higher in at least one of the three recent fiscal years for which ED data are available (i.e., FY92, FY91, and FY90);

- 160 institutions have default rates of 25 percent or higher for the most recent fiscal year; and

- 59 institutions have defaults rates of 25 percent or higher in both of the two most recent fiscal years.

Furthermore, well over 100 institutions accepted for the second year, of which the vast majority were proprietary institutions, had default rate data that are missing or potentially unreliable for the previous three years.

Because these institutions with high default rates or potentially unreliable data represent less than two (2) percent of 1993 FFELP loan volume, they are not likely to have a major impact on future FDLP volume. Nonetheless, their participation could contribute in a disproportionate way to a perception that the program is failing to ensure institutional quality. Since ED has considerable flexibility under the law in choosing institutions that are "reasonably representative," it could have screened institutions more carefully to ensure quality.

Second, current ***selection criteria***, as they have been applied for 1995-96, do not appear to be adequate to prevent entrance of even more high-default institutions. The Committee understands that waivers may be appropriate for certain schools serving largely disadvantaged student populations and that objections have been raised about creating criteria for the FDLP more stringent than for other loan programs. Nonetheless, the criteria as currently structured appear to invite problems in the long-run, especially because other selection factors related to administrative capability will be relaxed in future years. In light of OIG's and the General Accounting Office's (GAO's) concerns about ED's gatekeeping function, the current criteria must be examined very closely.

Third, there appears to be no plan to *monitor institutional quality*. The existence of an income contingent repayment option in the FDLP--an option that S.495, the "Student Loan Evaluation and Stabilization Act of 1995," would extend also to the FFELP--offers new opportunities for mismanagement by institutions of poor quality. While it is technically still possible to be delinquent, or in default, on an FDLP loan, institutions could use income contingency as a management tool to mask the consequences of poor educational programs. The Advisory Committee knows of no plan by ED that addresses this issue either at the application stage or through monitoring of institutional performance. Similar problems will emerge in the FFELP if income contingent repayment becomes available under that program.

Fourth, ED has not yet identified or analyzed alternative *measures of institutional quality* in the FDLP that will serve the same program integrity function as the default measure in the FFELP. Instead, there appears to be a widespread feeling on the part of ED management that default is, by definition, minimized under the FDLP, and consequently, that there is less need for such a measure.

In order to ensure program integrity, the Advisory Committee would urge ED to take corrective actions in each of these four areas:

- With regard to institutions already in the FDLP, ED should review its *selection process* and perform an analysis that identifies problem schools. As part of this process, ED should consider replacing these institutions with those having lower default histories--especially with institutions that applied and were not selected for reasons other than quality.
- ED should develop new *selection criteria* designed to prevent the participation of institutions that are likely to have excessively high default rates or to misuse the income contingent repayment option.
- ED should formulate a system to *monitor institutional quality* that tracks and reports the use of the income contingent repayment option in the case of schools that are potential problems. This system must be able to detect unusual shifts in payment option selection as well as payment streams that signal likely program integrity problems. The system must also subject such institutions to intensive monitoring across other key indices.
- ED should carefully analyze and compare alternate *measures of institutional quality* that can be used to monitor and eliminate problem schools. These include delinquency and default rate in repayment options other than income contingent repayment, frequency of administrative assignment of delinquent and defaulted loans to income contingent repayment, and rate of selection and nonpayment in income contingent repayment. Other potential measures are withdrawal or dropout rates, program completion

rates, and success of graduates obtaining employment or meeting their educational objective.

In summary, the participation of institutions with high default rates, the absence of appropriate measures of quality equivalent to cohort default rates, and the failure to monitor institutional performance in light of these measures will have a predictable negative impact on program integrity in the FDLP. It is important that ED move aggressively in each of these areas.

As part of its continuing evaluation of the loan programs, the Advisory Committee will explore over the next few weeks measures that might be used as alternatives to cohort default rates. This will be a focus of the Advisory Committee's hearing in April. The Committee will make these analyses available to the Congress as soon as they are completed.

In the meantime, on behalf of each of our members, I would encourage you to consider the recommendations outlined above as a preliminary framework for your oversight hearings. Thank you for the opportunity to provide these recommendations. Please let us know if we can be of further help in this matter.

Sincerely,

Lynn M. Fawthrop

Lynn M. Fawthrop
Chairperson

cc: The Honorable Nancy Landon Kassebaum (identical original sent)
Advisory Committee members
Members of the Committee on Labor
and Human Resources
Members of the Committee on Economic
and Educational Opportunities
The Honorable Richard W. Riley
The Honorable Madeleine M. Kunin
The Honorable Marshall S. Smith
The Honorable David A. Longanecker
Mr. Leo Kornfeld

Student Loan Program Simplification:
Interim Recommendations

A Report to the Congress of the United States
and the Secretary of Education

Advisory Committee on Student Financial Assistance

April 1993

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FOREWORD

Congress created the Advisory Committee on Student Financial Assistance when it enacted the Higher Education Amendments of 1986. The Advisory Committee serves as an independent source of advice and counsel to the Congress and the Secretary of Education on student aid policy. Congress originally defined its purpose in statute: to provide extensive knowledge and understanding of Federal, state, and institutional programs of postsecondary student assistance; to provide technical expertise with regard to systems of need analysis and application forms; and to make recommendations that will result in maintenance of access to postsecondary education for low- and middle-income students.

The Advisory Committee's most recent focus results from the reauthorization of the Higher Education Act of 1965. Due in large part to its contribution to the reauthorization process, the Advisory Committee was asked by Congress to monitor implementation of the Education Amendments of 1992, address unresolved issues of reauthorization, and conduct a study of loan program simplification.

The Advisory Committee's structure reflects the diversity of the contemporary financial aid community. College presidents, financial aid administrators, educational association executives, bank officers, guaranty agency executives, state higher education officials, and students have served on the Committee. Members are appointed by the leaders of the United States Senate, the House of Representatives, and the Secretary of Education on the basis of technical expertise and knowledge of student aid and educational policy. The eleven members serve in staggered terms of three years. These members and Committee staff are listed in Appendix C.

EXECUTIVE SUMMARY

The Advisory Committee on Student Financial Assistance has conducted a congressionally mandated loan simplification study this year, which has included three hearings, one meeting, and one symposium as primary activities to consider issues concerning simplification of the Federal Family Education Loan Program (FFELP). In addition, Senator Claiborne Pell, in a letter dated March 3, 1993, requested that the Committee expand its study to include an examination of direct lending. Federal budget constraints may result in the FFELP being converted into a direct lending program in which educational institutions originate loans. Senator Pell specifically requested that the Committee examine how direct loans might be incorporated into the overall Title IV delivery system.

As a result of Committee analysis resulting from hours of testimony from leaders in financial aid and student lending, the Advisory Committee has gathered compelling evidence that the current program structure and operations are needlessly complex and require major reform. Complexity in the FFELP results from multiple, overlapping loan programs with conflicting terms and conditions. Nonstandard policies, procedures, forms, and processes also plague the program, in addition to burdensome legislative and regulatory requirements. The thousands of parties in the process who are not linked by an adequate data or network infrastructure contribute to the complexity. The result is unacceptable confusion and inefficiency for students and institutions.

In light of the current debate between proponents of direct lending and FFELP and the ongoing policy debate, the Advisory Committee felt strongly that an interim report to Congress and the Secretary should be generated to communicate its recommendations. The Advisory Committee is making recommendations for both the FFEL and direct lending programs in order to ensure a streamlined, simplified system of delivering student loan funds through either program.

The Advisory Committee recommends a radical restructuring of the FFELP through consolidation of participants, creation of a single loan program with standard terms and conditions, and integration of the loan process into the existing Title IV delivery system. To create an efficient, effective direct lending program, the new single loan program must be implemented with standard terms and conditions and must be fully integrated into the Title IV delivery system. This program must not require any interface with the prior FFELP beyond capture of default information and must remain a centralized, federal program with a minimal number of participants outside the educational institutions.

The Committee will discuss final recommendations regarding student loan program simplification on June 3-4, 1993, in Annapolis, Maryland, prior to submission of its final report to Congress on July 23, 1993.

INTRODUCTION

In the Higher Education Amendments of 1992, Congress directed the Advisory Committee on Student Financial Assistance to conduct a study of the Federal Family Education Loan Program and submit a final report within one year. The statutory language mandating the study may be found in Appendix A. In anticipation of the enactment of P.L. 102-325, signed by the President in the summer of 1992, the Advisory Committee initiated its study activities in the spring.

Specifically, the Advisory Committee was charged with an examination of:

- the paperwork burden experienced by financial aid officers within the current structure of the loan program;
- simplification and standardization of forms, procedures, and all other aspects of guaranty operations for the purpose of data exchanges with the Department of Education, its proposed National Student Loan Data Base, and other agencies;
- simplification of the bank repayment process to minimize borrower confusion; and
- efficient utilization of loan programs to minimize multiple program borrowing in postsecondary education.

In addition, Congress required the Advisory Committee to focus on the effects on students and institutions of current sources of complexity and potential recommendations to simplify the program. The Committee approved a study plan in August 1992 that encompassed a number of activities intended to address these specific issues while facilitating community involvement. As part of the "discovery phase" of the study, the Advisory Committee conducted three hearings during the fall of 1992. The Committee received thousands of pages and dozens of hours of testimony from students, financial aid administrators, association representatives, guarantors, lenders, servicers, and secondary market spokespersons. Each was asked to identify sources of complexity in the existing loan process.

This report presents the Advisory Committee's interim recommendations to the Congress and the Secretary. These identify actions that are required to ensure that either the current FFELP or a new direct lending program meet the needs of both students and institutions.

PRELIMINARY FINDINGS

As a result of staff analysis and information presented at the hearings, the Advisory Committee identified six primary sources of complexity.

- Multiple, overlapping loan programs exist, none of which have sufficient annual limits to discourage multiple program borrowing.
- Terms and conditions conflict among the loan programs.
- The programs operate under burdensome legislative and regulatory requirements, most of which have been created to control program costs and default rates.
- Lender and guarantor policies are inconsistent.
- Loan processes and forms are not standard.
- The existing data and network infrastructure is insufficient.

Each of these became the focus of intensive investigation in the second phase of the study. The Committee saw compelling evidence of serious flaws in the current student loan programs. It became evident that nothing short of serious structural reform, especially in program delivery, would simplify and streamline the functioning of the FFELP.

Committee Solicitation

Using these preliminary findings as general guidelines, the Advisory Committee sent a solicitation in February 1993 to over 350 institutions, associations, guaranty agencies, secondary markets, lenders, and loan servicing organizations asking for their recommendations of strategies to address sources of complexity. The community submitted thirty-five proposals. Analysis of the proposals focused on identifying the most promising and feasible recommendations for program reform.

Senator Pell's Request

A new component was introduced to the study as a result of a letter dated March 3, 1993, from Senator Claiborne Pell to Advisory Committee Chairperson Lynn Burns requesting an expansion of the study. A copy of Senator Pell's letter is found in Appendix B.

Specifically, Senator Pell requested that, in light of renewed interest by Congress and the White House about a direct loan program, the Advisory Committee examine both a simplified student loan program and direct lending. He also requested that the Advisory Committee give:

> serious consideration to the feasibility of simplifying the manner in which both the current loan program and a direct loan program might be delivered. Because of changes made in the Pell Grant delivery system, I am especially interested in knowing if you believe either the current program or a direct loan program, or both, might use the Pell Grant system, as well as how it might be modified to accommodate use as a delivery mechanism for student loans. Is it, for example, possible to have one federal form, one processor, and one data base for all Title IV student aid programs?

As a result of the information obtained through its hearings and other sources, it became clear to the Committee that in order for the existing program to compare favorably with the delivery component of direct lending, radical changes would need to be implemented. Minor "tinkering" would not adequately streamline or simplify the FFELP.

Federal Budget Debate

The passage of President Clinton's budget package in the House of Representatives on March 18, 1993, and its subsequent passage by the Senate, created considerable uncertainty about the future of the existing program structure. The budget legislation, which requires a savings of over $4.0 billion over five years, seems to mandate the implementation of a full-scale direct lending program by 1997 to achieve savings for a national service program requested by the President. Opponents of the President's direct lending plan have suggested a number of proposals intended to reduce program costs in order to maintain the lender-based student loan program. However, such proposals could significantly alter the current structure by eliminating the administrative cost allowance to guaranty agencies, reducing reinsurance payments to lenders and guarantors, increasing reinsurance fees, and reducing special allowance rates. These actions would significantly reduce the number of guarantors, lenders, and secondary markets participating in the program.

As a response to the congressional timetables for the budget (May 14 for the House of Representatives and June 18 for the Senate), the Advisory Committee is issuing an interim report to provide support and information to Congress and the Secretary.

Dual Approach

The Committee has chosen to broaden its approach to the study to encompass the simplification of both the current loan programs and direct lending. Essential reform elements must be addressed if the Federal Family Education Loan Program is to continue. Similarly, if Congress is to avoid creating a costly, complex direct lending program and the associated increase in program implementation risks, it must address the issues raised by the study regarding the design of the program and its delivery mechanism.

RECOMMENDATIONS

Analysis of the testimony and proposals submitted to the Advisory Committee over the initial seven months of the study led to the identification of six program-wide imperatives for an efficient loan program. These constitute the primary findings of the study. The imperatives shaped the Advisory Committee's specific recommendations for both the FFELP and a direct lending program.

Program-wide Imperatives

There must be one student loan program with a single set of terms and conditions from which a majority of students can receive funding. The subsidized Stafford, unsubsidized Stafford, SLS, PLUS, and Perkins must be merged into a single program. The unified program's loan limits should combine the existing programs' limits, so that the individual's borrowing capacity is unaltered. In addition, all new loans must be issued with the same variable interest rate, and terms and conditions.

Implementation of single source borrowing is essential. This means that all of a borrower's loans must be guaranteed, originated, serviced, and held by one entity respectively. When possible, all of an institution's student loans should be guaranteed, originated, and serviced by a limited number of entities. This is the only approach that can improve and streamline processing, repayment, and communication among participants.

All borrowers must be offered the option of refinancing previous loans to obtain a single variable interest rate and merged deferment terms. This would assist in administrative consolidation, thus significantly decreasing administrative burden for all participants. Furthermore, it would substantially decrease federal expenditures for in-school subsidies, which are currently the most expensive component of the Federal Family Education Loan Program.

A broader range of repayment options must be made available at the request of the borrower. Borrowers must be given the option of graduated and income-contingent repayment schedules as well as other alternatives to facilitate repayment, such as expanded repayment periods for borrowers with higher balance loans.

The loan program must be fully integrated into the existing Title IV delivery system, utilizing the FAFSA as the application instrument. Experience has shown that any program relying on a separate delivery system will lead to multiple forms, processes, and regulations. Seven million students will complete the FAFSA this year, offering a logical opportunity to use this federal form in the loan application process. The Pell Grant component of the Title IV delivery system, which currently delivers almost $6.5 billion to 4.3 million students, also presents an effective method of fund disbursement. Incorporating the loan delivery system with Title IV delivery would minimize institutional confusion and burden. This would also address the issue of administrative capability, since no new delivery system would be required. Promissory notes are already required in the existing loan programs, and collection thereof would not increase the burden on institutions.

Implementation of a Title IV data base with sufficient monitoring and delivery capability is necessary to support an efficient and simplified loan program. However, this data base is not synonymous with the historical National Student Loan Data Base (NSLDB), the need for which is minimized if all new loans are issued at the same variable interest rate regardless of borrower loan history. As a result, efforts should be focused on creating a more centralized Title IV data system that is housed within the Central Processing System (CPS) and interfaces with the first phase of the NSLDB where necessary.

Recommendations for the FFELP

Using the identified program-wide imperatives as a guide, the Committee is making the following recommendations for changes in the existing FFELP program as summarized in Exhibit 1.

Create a new single FFELP loan program with subsidized and unsubsidized components, and with a single, variable interest rate and standard set of terms and conditions. Congress should merge the Stafford, SLS, PLUS, and Perkins loan programs, and create a unified loan program with a subsidized component for students and an

EXHIBIT 1

Recommendations for the Current FFELP

Create a new single FFELP loan program with subsidized and unsubsidized components and a single variable interest rate and a standard set of terms and conditions.

Reduce the number of lenders, guarantors, and secondary markets participating in the new program and require the remaining participants to demonstrate essential administrative capabilities and provide critical services.

Require that all loans originated under the new program carry the same standardized terms and conditions, including a single variable interest rate, without regard to the borrowers' previous loans under Part B and E.

Integrate the new program's delivery into an enhanced Title IV delivery system which utilizes the Free Application for Federal Student Aid (FAFSA) as its application document.

Implement a single source borrowing rule for all students.

As a condition of participation, require all lenders to allow borrowers to refinance prior loans so that the terms and conditions, including interest rates are consistent with the new program.

Establish graduated, income-contingent and extended repayment options, and require lenders to offer them to all borrowers. In addition, make expanded repayment mechanisms available to the Department of Education to assist in collections.

unsubsidized component for both students and parents. All new loans should be originated with the same variable interest rate and standardized terms and conditions. Loan limits should be combined under the current FFELP and Perkins programs.

> **Rationale:** The multiple and overlapping loan programs authorized under Parts B and E of the Higher Education Act, as amended, are a major cause of complexity. Congress will achieve simplification by combining the programs into a single program that incorporates the same variable interest rate for all loans and standardizes other terms and conditions, such as deferment and repayment options. This change will result in much simpler application and repayment processes. For example, borrowers would complete only one application per academic year rather than potentially several applications. Further, they would benefit from automatic administrative consolidation--which rarely occurs under the current system--and they would not have to deal with the often incomprehensible variation in terms and conditions that exist today. The associated reduction in administrative burden on institution in terms of processing and counseling are obvious.
>
> Consistency in the guarantee fees is also critical. According to testimony provided by several guaranty agencies, differences in these fees across guaranty agencies reflect its use as a marketing tool, rather than as a mechanism for addressing risk in the programs. A standard, set fee may decrease the dependency of some agencies on administrative cost allowance. Differences in fees also suggest unequal treatment of student borrowers.

Reduce the number of lenders, guarantors, and secondary markets participating in the new program and require the remaining participants to demonstrate essential administrative capabilities and provide certain critical services. To ensure simplification, Congress should use the need to reduce federal expenditures to minimize the number of loan program participants in a systematic manner. Proposals advanced by lenders, guarantors, and secondary markets to reduce administrative cost allowance and reinsurance rates, require immediate subrogation of defaulted loans, reduce special allowance rates and insurance payments from guaranty agencies, allow borrowers to refinance existing loans to a variable rate, and impose a single holder provision for all of a borrower's loans would inevitably have these consequences.

Further, the requirements for eligible participants should be revised to improve the overall performance of the system. At a minimum, eligible participants should have the capability: to perform electronic funds transfer; to offer refinancing of existing loans; to implement standard forms and processes (including minimum loan amounts, school reporting requirements, frequency of borrower contact, deferment documentation requirements, loan certification rules, and claim review/claim purchase policies); and the capability to provide loan consolidation and income-contingent, graduated and other alternative repayment schedules. In addition, any guaranty agency that wishes to participate in the program must agree to accept transfers of guarantees from agencies which become insolvent.

> **Rationale:** The sheer number of participants in the loan program represented by thousands of lenders, over 40 guaranty agencies, and numerous secondary markets has resulted in considerable expense to the federal government. It has also proven to be a significant barrier to simplification. For example, institutions, students, and their families must contend with forms, policies, and procedures that are unique to individual lenders, guaranty agencies and secondary markets.

Require that all loans originated under the new program carry the same standardized terms and conditions, including a single variable interest rate, without regard to the borrower's previous loans under Parts B and E. This would eliminate the requirement that borrower interest rates must be based on prior loans. A single variable interest rate would replace the existing rates. The same would hold true for other terms, such as deferment and repayment options.

> **Rationale:** The current statutory requirement that all loans of a borrower be held at the interest rate of his or her first loan was originally designed to benefit the student. However, it ceased to be an advantage several years ago when interest rates began declining and borrowers found themselves obtaining loans at noncompetitive rates in comparison to new borrowers. In addition, implementation of this proposal would obviate the need for institutions, lenders, or guaranty agencies to research borrowers' loan histories, thus also decreasing the need for a historical data base. All borrowers, regardless of their prior borrowing, will be able to obtain an interest rate on all new loans at a rate (in most cases) significantly less than their fixed rate loans. As a result, the federal government will save a

considerable amount of money for payment on in-school subsidies and on administrative support for a national loan data base.

Integrate the new program's delivery into an enhanced Title IV delivery system which utilizes the Free Application for Federal Student Aid (FAFSA) as its application document. This year over seven million students in 42 states will rely on the FAFSA alone to deliver their federal, state, and institutional aid. While there would still be a need to generate a separate promissory note, combining the student loan application process into the FAFSA process is the final step in integrating all federal and state financial aid programs into a unified system with a single application.

> **Rationale:** The existing Title IV delivery system functions very efficiently, with over 5,000 institutions currently submitting and receiving data through the Department of Education's Central Processing System (CPS). Enhancements required to add loan information to the existing system would be minimal. The utilization of this system would facilitate the processing of applications and the delivery of funds as well as significantly reduce the paperwork burden associated with the FFELP. In addition, implementation would assure that applicants are considered for all forms of aid for which they may be qualified. Both students and institutions would benefit as a result.

Implement a single source borrowing rule for students. All of a borrower's loans must be guaranteed by one agency, originated by one lending institution, and held by one secondary market or lender under the new program. This would be an expansion of the language found in the Higher Education Amendments of 1992 which encourages, but does not require such a practice. To participate in the program, lenders would not be able to use different servicers for any individual's loan portfolio. In addition, lenders and loan servicers would have to provide a single repayment schedule for all loans of a given borrower and require a single minimum monthly payment to cover all of the borrower's loans. If a borrower wishes to establish a relationship with a new lender or guarantor, all existing loans must be refinanced or transferred to the new lender or agency at the request of the borrower. Wherever possible, all of an institution's loans should be originated, guaranteed, and serviced by a limited number of entities.

Rationale: Single source borrowing addresses a series of problems that exist in the current FFELP program. For example, borrowers are frequently unable to identify the holders of their loans because there may be more than one and loans are often sold by holders to other holders. This prevents borrowers and institutions from successfully communicating with holders about matters that range from change of address to problems associated with deferments and repayments. If single source borrowing is adopted, borrowers and institutions would be able to identify holders easily. This would mean that a single request for information or submission of demographic or enrollment changes to a guaranty agency or lender would be all that is necessary to update a borrower's file. Students would have to communicate with only one holder about questions and problems and to repay only one entity through a single repayment schedule. This would also minimize the number of entities with which institutions must interact.

As a condition of participation, require all lenders to allow borrowers to refinance prior loans so that the terms and conditions, including interest rates, are consistent with the new program. The proposal facilitates consolidation and would result in a significant reduction in federal interest subsidy expenditures.

Rationale: Implementation of the recommendations would benefit both borrowers and taxpayers. For example, repayment terms would be much more competitive for many borrowers, positively affecting the repayment for some who may have otherwise defaulted. Administrative consolidation would be more widely used because loans could be easily combined into one repayment schedule. Federal expenditures on in-school interest subsidies would also be significantly reduced if existing loans were refinanced at a lower variable rate rather than at the fixed rates. It should also be noted that some secondary markets may be required to reissue taxable bonds which were initially issued on a nontaxable basis because interest rates on the loans in their portfolio was a condition of their original bond issue.

Establish graduated, income-contingent and extended repayment options, and require lenders to offer them to all borrowers. In addition, make expanded repayment mechanisms available to the Department of Education to assist in collections. Flexible repayment options are the key to relieving the burdens of repayment that borrowers often experience. The proposal should also reduce the incidence of default.

> **Rationale:** With the increase in loan limits brought about by reauthorization, some borrowers may find a ten-year fixed repayment schedule yields an unmanageable monthly payment. Consolidation under current program rules, especially if funds have been borrowed from only one program, is too costly an alternative to obtain a longer repayment period. In addition, the borrower's first employment opportunity once out of school may be a low paying position that does not provide enough money to support and repay debts.

Recommendations for a Direct Loan Program

As with FFELP, there are a number of recommendations the Committee is making for any direct lending program developed by Congress. Exhibit 2 summarizes the Committee's recommendations.

Create a single direct loan program with subsidized and unsubsidized components, with a single, variable interest rate and standard set of terms and conditions. All new loans should be originated under the direct loan variable interest rate, terms and conditions. Congress should abolish the Stafford, SLS, PLUS, and Perkins loan programs, and create a single direct loan program with a subsidized component for students and an unsubsidized component for students and parents. All new loans should be originated with a variable interest rate and terms and conditions. Direct loans should not depend on prior FFELP borrowing.

> **Rationale:** Creation of a single program will reduce both confusion for borrowers and administrative burden for institutions because direct lending abolishes the five overlapping Part B and Part E loan programs. These programs contribute to complexity as a result of different interest rates and nonstandard terms and conditions, including deferment repayment options.

EXHIBIT 2

Recommendations for a Direct Loan Program

Create a single direct loan program with subsidized and unsubsidized components, with a single variable interest rate and standard set of terms and conditions. All new loans should be originated under the direct loan variable interest rate and terms and conditions.

Fully integrate direct lending into the existing Title IV delivery system, with the FAFSA as the loan application.

Require that holders permit current FFELP borrowers to refinance their FFELP loans under the same terms and conditions, including the same variable interest rates, as the direct loan program.

Enhance the existing Department of Education collection contracts for servicing of direct loans.

Ensure that no interface between the direct loan program and the FFELP is required beyond capture of default information.

Design direct lending delivery to permit direct interaction between institutions and the Department of Education without numerous intermediaries.

Fully integrate direct lending into the existing Title IV delivery system, with the FAFSA as the loan application. This would provide a single structure for application processing, data management, disbursement and reporting functions. Data required for all Title IV programs would be processed through the Central Processing System (CPS) and directly delivered to institutions by the Department of Education.

> **Rationale:** The implementation of this recommendation would create a single structure based on the current delivery system (i.e., Central Processing System and Financial Management System) for application processing, data management, disbursement, and reporting functions. This structure would capture, retain, and track relevant loan data, thereby eliminating many of the administrative and processing steps required in the current loan system. Paperwork burden would be reduced, delivery of funds would be expedited and simplified, and reporting requirements would be streamlined. As was stated in testimony before the Advisory Committee, originating a loan utilizing the Title IV delivery system should be "no more difficult than disbursing a Pell Grant." In addition, the Department would be able to monitor closely changes in fund request patterns, thus potentially identifying problems at institutions much more quickly than the existing system permits. Such problems include fraud and abuse, which can go undetected under the current system due to the absence of an adequate, centralized data base.

Require that holders permit current FFELP borrowers to refinance their loans under the same terms and conditions, including the same variable interest rates, as the direct loan program. Borrowers under direct lending should have the option to consolidate their FFELP loans through refinancing. FFELP holders must be required to honor the borrowers' requests to refinance.

> **Rationale:** Refinancing will allow all borrowers both to take advantage of much lower interest rates on most outstanding loans and to consolidate or group their loans automatically into a single repayment schedule. The proposal would also considerably reduce federal expenditures on in-school and deferment subsidies.

Enhance the existing Department of Education collection contracts for servicing of direct loans. ED should issue a small number of contracts to servicers that will collect direct loans. Their responsibilities should be expanded to include the capability to offer graduated and income-contingent repayment schedules.

> **Rationale:** In order to minimize the number of servicers with which institutions must interact on behalf of their students, the number of servicing contracts must be small. Expanded repayment options will simplify and streamline the repayment process. In addition, such options may assist in averting default, especially for those individuals with high loan balances.

Ensure that no interface between the direct loan program and the FFELP is required beyond capture of default information. Establish borrower eligibility and other criteria to ensure the independence of the direct lending program. Extensive interactions between the two programs will unnecessarily complicate direct lending. The only interface required should be the capture of default information.

> **Rationale:** Requirements, such as dependency on borrower loan history to originate new loans, would unnecessarily complicate a system of direct lending. If no interface beyond default information is required, there would be no need to continue development of the NSLDB, or to continue processing Financial Aid Transcript requests or Student Status Confirmation Reports. The Central Processing System (CPS) alone would be able to track defaults, as well as annual and cumulative loan limits. The CPS could also monitor and update deferment status. This would significantly decrease the paperwork burden and administrative costs for institutions in addition to simplifying loan counseling and awarding.

Design direct lending delivery to permit direct interaction between institutions and the Department of Education without numerous intermediaries. The primary delivery process for direct loans should link ED directly with institutions. Intermediaries, including alternate originators, should be limited in number and function.

Rationale: The current programs are unnecessarily complicated by numerous intermediaries. The more participants involved, the greater the opportunity for multiple forms, policies, and processes, as is seen in the current program. There is no reason for multiple entities to be involved in the delivery of loan proceeds, since this process can be adequately administered by the institutions involved in the program. The addition of other participants to the program will delay delivery, add to the paperwork and reporting burden, and increase costs of program operations.

Further Study Activities and Recommendations

The Committee has scheduled one additional hearing to be held June 3-4, 1993, in Annapolis, Maryland, which will have as one of its primary topics a further discussion of direct lending in order to examine President Clinton's proposal. A final report detailing the Committee's full set of recommendations regarding loan simplification will be submitted to Congress and the Secretary of Education in July 1993.

APPENDIX A

(l) STUDENT LOAN PROGRAM SIMPLIFICATION. - (1) The Advisory Committee shall conduct a thorough study of means of simplifying all aspects of the loan programs under part B of this title. In carrying out the study, the Advisory Committee shall examine, at a minimum-

(A) reduction of paperwork burdens experienced by financial aid administrators resulting from the current structure of such loan programs;

(B) promotion of simplification and standardization of forms, procedures, and all other aspects of guaranty agency operations for the purpose of facilitating data exchanges with such agencies (including the National Student Loan Database) and facilitating Department of Education oversight;

(C) simplification of the repayment process to minimize borrower confusion, including encouragement of single holder ownership of all of an individual's loans;

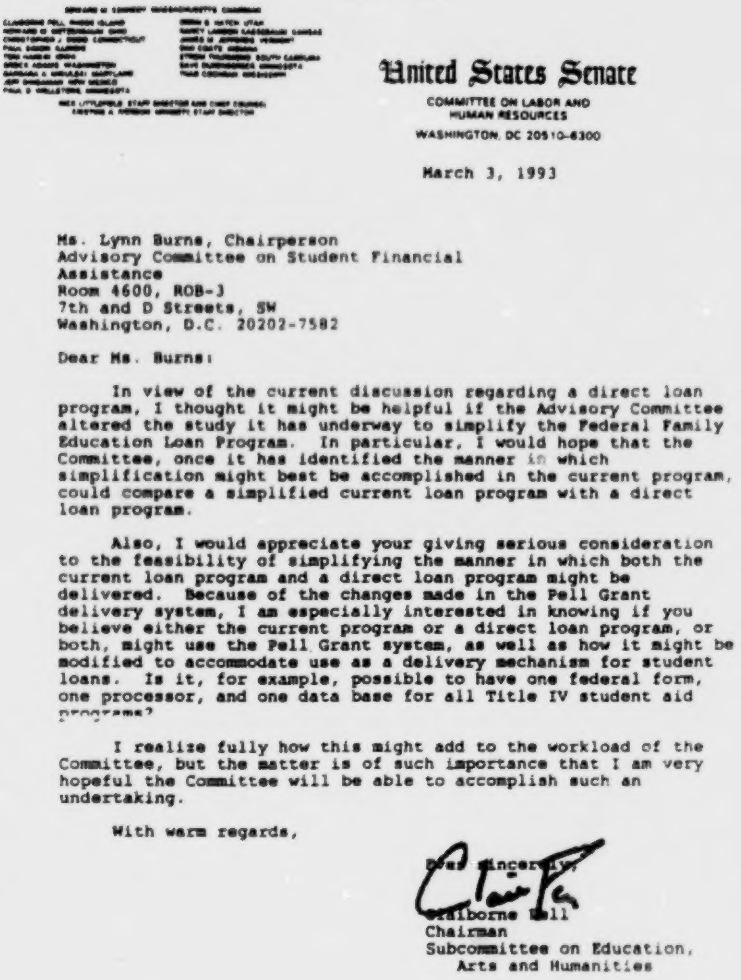
(D) encouragement of efficient utilization of loan programs to minimize multiple program borrowing in postsecondary education; and

(E) other proposals which are designed to reduce the administrative burdens on, and paperwork required of, students, educational institutions, guaranty agencies, lenders, secondary markets, and the Secretary submitted in response to a general solicitation by the Advisory Committee.

(2) The Advisory Committee shall consult with the Committee on Education and Labor of the House of Representatives and the Committee on Labor and Human Resources of the Senate in carrying out the study required by this subsection.

(3) The Advisory Committee shall, not later than 1 year after the date of enactment of this Act, prepare and submit to the Committee on Education and Labor of the House of Representatives and the Committee on Labor and Human Resources of the Senate a report on the study required by this subsection.

APPENDIX B



United States Senate
COMMITTEE ON LABOR AND
HUMAN RESOURCES
WASHINGTON, DC 20510-6300

March 3, 1993

Ms. Lynn Burns, Chairperson
Advisory Committee on Student Financial
Assistance
Room 4600, ROB-3
7th and D Streets, SW
Washington, D.C. 20202-7582

Dear Ms. Burns:

In view of the current discussion regarding a direct loan program, I thought it might be helpful if the Advisory Committee altered the study it has underway to simplify the Federal Family Education Loan Program. In particular, I would hope that the Committee, once it has identified the manner in which simplification might best be accomplished in the current program, could compare a simplified current loan program with a direct loan program.

Also, I would appreciate your giving serious consideration to the feasibility of simplifying the manner in which both the current loan program and a direct loan program might be delivered. Because of the changes made in the Pell Grant delivery system, I am especially interested in knowing if you believe either the current program or a direct loan program, or both, might use the Pell Grant system, as well as how it might be modified to accommodate use as a delivery mechanism for student loans. Is it, for example, possible to have one federal form, one processor, and one data base for all Title IV student aid programs?

I realize fully how this might add to the workload of the Committee, but the matter is of such importance that I am very hopeful the Committee will be able to accomplish such an undertaking.

With warm regards,

Sincerely,

Claiborne Pell
Chairman
Subcommittee on Education,
Arts and Humanities

APPENDIX C

LIST OF MEMBERS AND STAFF
Advisory Committee on Student Financial Assistance
Current Members By Class of Appointment

Class of 1993
(Term expires September 30, 1993)

Ms. Lynn M. Burns
Director of Financial Aid
Roger Williams University
Bristol, Rhode Island 02809
(U.S. Senate appointee)

Mr. James R. Craig
Director of Financial Aid Services
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Bozeman, Montana 59717
(House of Representatives appointee)

Dr. Horace W. Fleming, Jr.
Executive Vice President and Provost
Mercer University
Macon, Georgia 31207-0001
(Secretary of Education appointee)

Class of 1994
(Term expires September 30, 1994)

Dr. Robert E. Alexander
Chancellor
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Dr. William C. Hiss
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Class of 1995
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Mr. Stephen Biklen
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Dr. Stanley Z. Koplik
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Dr. David K. Malek
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Division of Natural Sciences
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Hixson, Tennessee 37343
(Secretary of Education appointee)

Advisory Committee Staff

Dr. Brian K. Fitzgerald
Staff Director

Dr. William J. Goggin
Staff Economist

Ms. Hope M. Gray
Staff Assistant

Ms. Tracy D. Jones
Staff Secretary

Ms. Ardena N. Leonard
Research Assistant

Ms. Debra L. Schweikert
Associate Staff Director

IMPLEMENTATION OF THE FEDERAL DIRECT STUDENT LOAN PROGRAM AND MODIFICATIONS TO THE FEDERAL FAMILY EDUCATION LOAN PROGRAM

A Report to the Congress of the United States
and the Secretary of Education

Advisory Committee on Student Financial Assistance

August 1994

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FOREWORD

Congress created the Advisory Committee on Student Financial Assistance when it enacted the Higher Education Amendments of 1986. The Advisory Committee serves as an independent source of advice and counsel to the Congress and the Secretary of Education on student aid policy. Congress originally defined its purpose in statute: to provide extensive knowledge and understanding of Federal, state, and institutional programs of postsecondary student assistance; to provide technical expertise with regard to systems of need analysis and application forms; and to make recommendations that will result in the maintenance of access to postsecondary education for low- and middle-income students.

The Advisory Committee's most recent focus comes from the changes made to the Higher Education Act of 1965 as amended by the Higher Education Amendments of 1992 and the Omnibus Budget Reconciliation Act of 1993. Congress has asked the Advisory Committee to conduct an evaluation of the Federal Direct Student Loan Program and the Federal Family Education Loan Program.

The Advisory Committee's structure reflects the diversity of the contemporary financial aid community. College presidents, financial aid administrators, educational association executives, bank officers, guaranty agency executives, state higher education officials, and students have served on the Advisory Committee. Members are appointed by the leaders of the United States Senate, the House of Representatives, and the Secretary of Education on the basis of technical expertise and knowledge of student aid and educational policy. The eleven members serve in staggered terms of three years. Advisory Committee members and staff are listed in Appendix B.

EXECUTIVE SUMMARY

Congress passed legislation during the last two years that has fundamentally altered the student loan programs. Congress included provisions in the Higher Education Amendments of 1992 to simplify and streamline the loan programs, expand repayment options, and increase loan limits, among many others. More recently, the Omnibus Budget Reconciliation Act (OBRA) of 1993 further modified the programs. OBRA created a phased-in Federal Direct Student Loan Program (FDSLP), in which loan volume will increase from five percent in academic year (AY) 1994-95 to at least sixty percent in AY 1998-99. OBRA also dramatically altered the financing of the Federal Family Education Loan Program (FFELP); the bill phased in a series of changes that reduced loan interest rates and subsidy levels to guarantors, lenders, and secondary markets and implemented risk-sharing with lenders and cost-sharing with states.

House and Senate OBRA conferees directed the Advisory Committee on Student Financial Assistance to advise the Secretary and the Congress on the operation of both the FDSLP and the FFELP. The Advisory Committee's primary charge is to monitor all aspects of the implementation of the FDSLP and significant modification of the FFELP. The Advisory Committee's approach flows from its previous, congressionally mandated loan simplification study that produced recommendations to reduce complexity in the FFELP and avoid complexity in the FDSLP. Using the loan simplification study as a framework, the Advisory Committee examined issue areas in both programs that corresponded to the timing of program changes and milestones for AY 1993-94. As a result, this report addresses partial implementation of the FDSLP and the preliminary or announcement effects of changes to the FFELP.

The Department of Education successfully implemented numerous essential components of the FDSLP in a timely manner and put into place significant modifications to the FFELP. In spite of these achievements, important improvements are necessary in both programs.

The Advisory Committee evaluated implementation of the FDSLP by examining the Department's progress in three broad issue areas. The areas consisted of ***program design and implementation activities, systems design and implementation, and administrative structure and processes***.

The Department had less than one year to undertake fundamental ***program design and implementation activities*** to bring the FDSLP on-line for 1994-95 and plan for substantial growth in the FDSLP volume and institutional participation in subsequent years. The Department successfully initiated timely procurement of contracts, development of procedures for originating direct loans, publication of regulations, and forms preparation. However, the Advisory Committee believes that basic modifications to disbursement rules and certain terms and conditions are necessary to avoid causing complexity and administrative workload in the

FDSLP. The Advisory Committee recommends that the Department take necessary legislative or regulatory steps to improve program design. The Department should:

- *Ensure that FDSLP disbursement rules coincide with the Pell Grant and Campus-Based programs; and*

- *Make terms and conditions between the FFELP and the FDSLP identical by establishing long-term solutions to certain deferment problems, such as those affecting borrowers participating in medical residencies.*

The Department's *systems design and implementation activities* allowed the FDSLP to start up by July 1, 1994. The Department fulfilled the responsibility by developing software and mainframe specifications, establishing processes vital to the operation of the FDSLP, and designing the necessary interfaces between FDSLP data bases and existing data bases. However, improvements are required in the system design, the FDSLP processing system, dependence on the National Student Loan Data System (NSLDS), and software and administrative procedures to avoid a long-term negative effect on the FDSLP. The Advisory Committee believes that the Department, which no longer faces the original time constraints, must make necessary improvements to the FDSLP. The Department should:

- *Create a comprehensive FDSLP system design based on the latest technology that addresses current shortcomings in FDSLP operations;*

- *Make key changes to the current FDSLP processing system that assure program integrity to prevent disbursements from multiple institutions and loans in excess of statutory limits;*

- *Reassess the FDSLP's dependence on the National Student Loan Data System and clarify a contingency plan in the event that the system cannot perform the functions originally anticipated in a timely fashion; and*

- *Modify the PC software and administrative procedures to minimize complexity and workload for institutions;*

The Department established critical *administrative structures and processes* to implement and maintain the FDSLP. It handled management and staffing needs, conducted the timely recruitment and selection of appropriate institutions for the AY 1994-95 FDSLP cohort, began the recruitment and selection process for the AY 1995-96 cohort, and addressed other administrative functions. The Department put important administrative structures and processes in place in a very short time. However, the Advisory Committee recommends that the Department should modify training and communications to facilitate institutional participation. In order to do so, the Department should:

- *Improve the timing and the techniques used for institutional training; and*

- *Improve communication between the Department and institutions currently participating in the FDSLP as well as institutions considering participation.*

The Higher Education Amendments of 1992 and OBRA incorporated provisions to streamline and simplify the FFELP in concert with phasing in the FDSLP. Despite concerns about FFELP stability during the implementation of the FDSLP, the program has remained healthy, in part because of a significant growth in loan volume in fiscal year (FY) 1994. In addition, other major changes to the program, such as decreased subsidy levels and expected volume losses to the FDSLP, will not occur until July 1994 and July 1995, respectively.

The Department addressed the transformation of the FFELP implementing initiatives during AY 1993-94 to avoid a possible collapse of the guaranty agency system. The initiatives included oversight of the orderly mergers of certain guaranty agencies. formation of a Transition Task Force and efforts by the Guarantor and Lender Oversight staff to ensure the stability of the guaranty agency system and creation of a Transition Guaranty Agency to deal with guaranty agency closures.

The Advisory Committee's examination of the FFELP during AY 1993-94 was limited by the staggered implementation of program changes and by lack of access to Department data about the guaranty agency system and lenders of last resort. Despite these constraints, the Advisory Committee finds that the FFELP is stable, but believes that the Department must make improvements in the areas of *monitoring lender withdrawals and changes in lender policies*, *ensuring lenders-of-last-resort*, and reassessing the viability of the *National Student Loan Data System*. The Advisory Committee proposes the following recommendations for improving the Department's oversight of the FFELP. The Department should:

- *Develop a system to monitor lender withdrawals from the FFELP and changes in FFELP lender policies that can affect access to loan capital;*
- *Ensure that a lender-of-last-resort is available to all students; and*
- *Reevaluate the planned FFELP dependence on the National Student Loan Data System to perform loan and delivery system functions, and develop a contingency that employs existing options.*

The Advisory Committee believes that implementation of these recommendations will ensure the development of an effective FDSLP and a smooth transition in the FFELP. In addition, the Department should take administrative steps to implement the Advisory Committee's recommendations to simply further the FFELP for students. Streamlining application documents and processes, minimizing the number of guarantors and lenders, and standardizing guarantor and lender policies should be considered instruments of program simplification.

INTRODUCTION

Congress has passed legislation during the last two years that has fundamentally altered the student loan programs. First, Congress included provisions in the Higher Education Amendments of 1992 to simplify and streamline the loan programs; the statute also authorized the Direct Loan Demonstration Program. In addition, it made several significant changes to the Federal Family Education Loan Program that included: expanded repayment options; increased loan limits; fewer deferment categories; an unsubsidized loan program; and requirements to standardize forms, processes, and procedures. More recently, the Omnibus Budget Reconciliation Act of 1993 further modified the programs. OBRA created a phased-in Federal Direct Student Loan Program, in which loan volume will increase from five percent in academic year 1994-95 to at least sixty percent in AY 1998-99. OBRA also restructured the FFELP by integrating Federal Supplemental Loans to Students (SLS) and the Federal Stafford Unsubsidized Loan Program and amending the lender-of-last-resort provisions. Perhaps most importantly, OBRA dramatically altered the financing of the FFELP. The bill phased in a series of changes that reduced loan interest rates and subsidy levels to guarantors, lenders, and secondary markets, and implemented risk-sharing with lenders and cost-sharing with states.

In addition, House and Senate OBRA conferees directed the Advisory Committee on Student Financial Assistance to advise the Secretary and the Congress on the operation of both the FDSLP and the FFELP. The Advisory Committee's primary charge is to monitor all aspects of the implementation of the FDSLP and modification of the FFELP. The Advisory Committee is required to report its observations annually over three years beginning in 1994 and make recommendations on the advisability of fully implementing the FDSLP in a final report due no later than January 1, 1997.

The Advisory Committee's evaluation is linked to its previous, congressionally mandated loan simplification study that produced recommendations to reduce complexity in the FFELP and avoid complexity in the FDSLP. The results of the loan simplification study appear in the 1993 publication, ***Report on Student Loan Program Simplification***. Congress incorporated a number of the recommendations into OBRA. Furthermore, the study established a framework for the Advisory Committee to assess the FDSLP and the FFELP based on principles that promote: streamlined application processes, decreased institutional and student burden, reduced number of loan programs, reduced number of parties with which students must interact, standardized processes for obtaining and repaying loans, and integration of student loans into the Title IV delivery and tracking system.

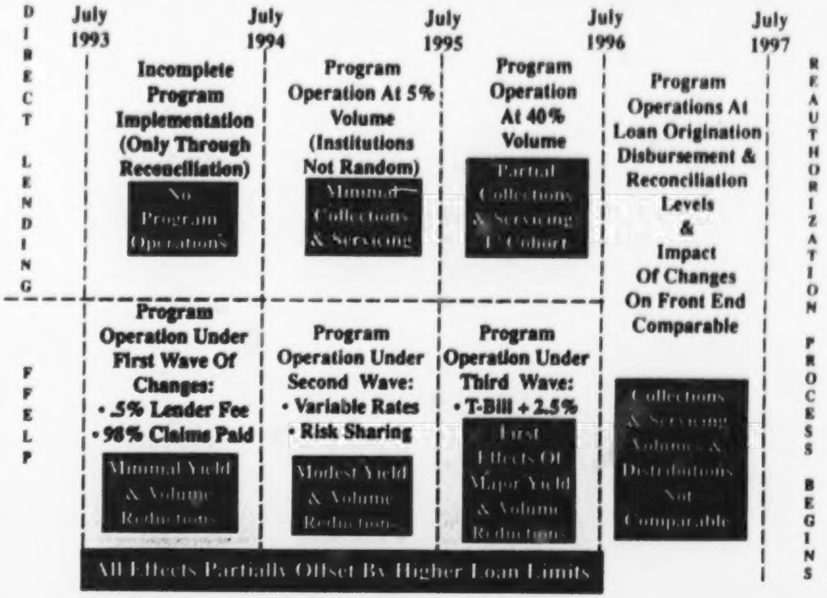
SCOPE OF THE REPORT

This report reflects the Advisory Committee's observations for the 11 months since the passage of OBRA. During this period, the Department of Education put into place essential administrative components of the FDSLP and implemented changes to the FFELP. However, the full effects of OBRA will not be observed for some time for a number of reasons. First, as Exhibit 1 shows, the FDSLP is phased-in over a period of several years. Second, as Exhibit 1 also illustrates, the modifications to the FFELP occur in stages; some of the most important changes, which will have significant impact on the programs, do not occur until July 1, 1994 and July 1, 1995. The timing of these program changes and milestones delays effects and prevents direct comparisons about relative effectiveness and costs in the near term between the FDSLP and the FFELP. Third, increased loan limits enacted under the Higher Education Amendments of 1992 are an important mitigating factor. The new loan limits produced a significant increase in FFELP loan volume in FY 1994, which has resulted in some delay in the impacts of OBRA on the FFELP participants, particularly guaranty agencies, perhaps until AY 1995-96.

This combination of factors limits the scope of the first-year evaluation and this report. Nonetheless, the Advisory Committee was able to examine important processes related to preliminary implementation of direct lending and the anticipatory or announcement effects of the changes to the FFELP that will occur in AY 1994-95.

Exhibit 1

Timing Of Legislative & Program Changes:
Constraints On Loan Program Evaluations & Comparisons



July 1993 | July 1994 | July 1995 | July 1996 | July 1997

DIRECT LENDING

Incomplete Program Implementation (Only Through Reconciliation)
No Program Operations

Program Operation At 5% Volume (Institutions Not Random)
Minimal Collections & Servicing

Program Operation At 40% Volume
Partial Collections & Servicing 1st Cohort

Program Operations At Loan Origination Disbursement & Reconciliation Levels & Impact Of Changes On Front End Comparable
Collections & Servicing Volumes & Distributions Not Comparable

FFELP

Program Operation Under First Wave Of Changes:
- .5% Lender Fee
- 98% Claims Paid

Minimal Yield & Volume Reductions

Program Operation Under Second Wave:
- Variable Rates
- Risk Sharing

Modest Yield & Volume Reductions

Program Operation Under Third Wave:
- T-Bill + 2.5%

First Effects Of Major Yield & Volume Reductions

All Effects Partially Offset By Higher Loan Limits

REAUTHORIZATION PROCESS BEGINS

BEST COPY AVAILABLE

FEDERAL DIRECT STUDENT LOAN PROGRAM

Congress transformed the relatively small Direct Loan Demonstration Program into a major program with the enactment of OBRA on August 10, 1993. It presented the Department with the challenge of an 11-month implementation schedule in order to begin making loans on July 1, 1994 at 104 institutions that account for approximately five percent of the FFELP's FY 1991 loan volume. The Department also faced the task of establishing the FDSLP to accommodate sharp increases in loan volume beginning at five percent and rising to at least 60 percent over a four-year period from AY 1994-95 to AY 1998-99.

The Advisory Committee evaluated implementation of the FDSLP by examining the Department's progress in three broad issue areas. The areas consisted of ***program design and implementation activities, systems design and implementation, and administrative structure and processes***. The following narrative describes the Advisory Committee's observations and recommendations.

PROGRAM DESIGN AND IMPLEMENTATION ACTIVITIES

The Department had less than one year to create a program design and initiate basic implementation activities that could bring the FDSLP on-line for AY 1994-95 and that could accommodate substantial growth in the FDSLP volume and institutional participation in subsequent years. The Department successfully initiated essential program design and implementation activities critical to the success of the FDSLP, including:

- Completion of a master calendar;
- Procurement on schedule of important contracts, such as software development, loan servicing, payment management and funds delivery, training, and evaluation;
- Development of procedures for originating, servicing, and collecting direct loans;
- Publication of all regulations governing the program for AY 1994-95 and certain regulations for 1995-96;
- Participation in negotiated rulemaking to develop regulations for AY 1995-96 and beyond;
- Establishment of the Free Application for Federal Student Aid (FAFSA) as the FDSLP application; and
- Production of promissory notes, deferment forms, and applications for loan consolidation on time for the July 1, 1994 implementation date.

These activities are critical to starting the FDSLP on schedule and maintaining it once it becomes operational. The Department's success demonstrates its capacity to implement essential components of the FDSLP.

However, the Advisory Committee believes that basic modifications to *disbursement rules* and certain *terms and conditions* are necessary to avoid complexity and increased administrative workload in the FDSLP which may require statutory changes. These issues should be addressed before AY 1995-96 when loan volume could rise to 40 percent and the number of participating schools could reach between 1,000 and 2,000.

The Department has interpreted OBRA to require that FDSLP use certain FFELP disbursement rules that are likely to produce administrative complexity for institutions. First, the regulations require multiple disbursements for periods as short as a single term or semester. Second, under the current FDSLP rules, institutions do not have the flexibility, as they do for Perkins loans, to offer unequal disbursements of FDSLP to accommodate differences in costs between payment periods within an academic year, except limited circumstances. Third, the regulations require institutions to reconfirm enrollment status on the date of disbursement, instead of accepting the enrollment used for the Pell Grant and Campus-Based programs.

OBRA contains inconsistencies that result in utilization of the FFELP disbursement requirements in the FDSLP. For example, the statute mandates FDSLP payment periods that mirror the Pell Grant program but also references a section in part B of the statute that prescribes FFELP disbursements. The first-year regulations reflect the requirements of the FFELP, which will prove burdensome for FDSLP institutions without improving program integrity.

The Department also has interpreted OBRA to require the use of terms and conditions of the FDSLP program that are not consistently parallel with the FFELP for borrowers engaged in medical residencies. The statute specifies that the FDSLP's terms and conditions are to correspond to those in the FFELP. However, the Department has determined that the statute does not permit borrowers who are eligible for medical residency deferments on their outstanding FFELP loans to defer their FDSLP loans, because the statute does not specifically grandfather residency deferments under the FDSLP as it does for the FFELP. Some medical schools either have withdrawn from the 1994-95 cohort of direct lending institutions or have submitted conditional applications for the AY 1995-96 in response. The Department has addressed the issue for AY 1995-96 through a consolidation option. Although, at least one medical school has reconsidered its participation, the medical school community views the approach as an incomplete, short-term remedy.

The Advisory Committee recommends that the Department take necessary legislative or regulatory steps in the area of program design and implementation activities to:

- *Ensure that FDSLP disbursement rules coincide with the Pell Grant and Campus-Based programs.*
- *Make terms and conditions between the FFELP and the FDSLP identical by establishing long-term solutions to certain deferment problems, such as those affecting borrowers participating in medical residencies.*

SYSTEMS DESIGN AND IMPLEMENTATION

The Department designed and implemented systems that allowed the FDSLP to start up by July 1, 1994. The Department fulfilled the responsibility by:

- Developing and delivering on time software and mainframe specifications based on its EDExpress software package;
- Establishing processes vital to the operation of FDSLP, such as institutional draw-downs and distribution of funds through the Department's Payment Management System (EDPMS) and alternate disbursement; and
- Designing interfaces for the FDSLP data bases with existing data bases, such as the Central Processing System (CPS) and using the General Electronic Support (GES) system to transmit information.

The Department produced workable software, processes, and systems within a compressed time-frame. It also responded to a range of concerns about shortcomings in the software that were identified by the Advisory Committee and institutions.

Nonetheless, improvements are required in the *system design*, *FDSLP processing system*, *dependence on the National Student Loan Data System*, and *software and administrative procedures* to avoid long-term negative effects on the FDSLP. The Advisory Committee believes that the Department, which no longer faces the original time constraints for starting up the FDSLP, must initiate systems and software changes to design improvements.

The software and systems lack a comprehensive system design. The Department has developed software and systems based on the original Federal Direct Loan Demonstration Program without an ongoing design assessment to accommodate the change to a large-scale FDSLP. The absence of a comprehensive design has produced two sets of problems. First, the current system relies on relatively outdated and unnecessarily time-consuming technology, such as batch processing rather than on-line communication. Second, operational shortcomings have emerged, which are represented by other issues in systems design and implementation described in this section.

The FDSLP processing system, similar to other Title IV systems, permits disbursements to a borrower from more than one institution and allows certain students to receive loans in excess of statutory loan limits. Disbursements to a borrower from multiple institutions occur because of delays in the loan servicing system, caused by the Department's procedural and technological approaches. Specifically, burdensome procedures for updating information after transmitting borrower records to the loan servicing system have created a disincentive for institutions to book loans (i.e., transmit origination, promissory note and disbursement data to the servicer) promptly. As a result, many institutions will delay transmission of loan data to the servicer until after disbursement, potentially permitting students to receive loans at multiple institutions. The system also uses batch processing rather than real-time, on-line processing, which delays communication with institutions.

Certain borrowers can receive loans in excess of loan limits because the software and loan servicing system do not capture critical data elements or conduct important edits. For example, the institutional FDSLP software and the loan servicing system do not have data fields for cumulative debt, and thus cannot flag borrowers who have reached aggregate maximum loan levels. The National Student Loan Data System was to track loan limits, but NSLDS is not yet operational. In addition, the Department did not design the loan servicing system to capture dependency status, a criterion for determining borrower annual loan limits. The Department has linked the loan servicing system to the Central Processing System, which contains dependency status data; however, the loan servicing system apparently does not contain an edit for dependency status to ensure that dependent students, eligible for lower amounts than independent students, do not receive loans in excess of statutory limits.

The Department cannot depend in the near-term on the National Student Loan Data System to track aggregate loan limits or other functions for the FDSLP. The Department had planned to use NSLDS under the assumption it would be fully operational by start-up of the FDSLP. However, NSLDS, originally scheduled to be operational by July 1, 1993, has been subject to a series of delays that prevented the system from coming on-line by July 1, 1994, the FDSLP implementation date. Although a fall 1994 start up now is anticipated, the massive task of populating the data base with the guaranty agency records needed to track aggregate loan limits is scheduled to take place throughout the fall and winter of 1994. Additional delays are possible because the Department is reexamining the role and functions of NSLDS and how it fits with other Title IV systems. Furthermore, the link between institutions and NSLDS to permit submission of Student Status Confirmation Reports will be phased in at institutions over a period of years. As a result, the Department has initiated an alternate mechanism for collecting enrollment data through the FDSLP servicer.

The PC software and associated administrative procedures designed by the Department produce complexity and increased workload for institutions using the FDSLP PC software. Institutions using mainframe computers have not experienced these problems. For example, the FDSLP PC software is loan-specific rather than borrower-specific. It requires institutions to key and rekey a significant amount of information on all borrower records and to create separate loan records to certify subsidized and unsubsidized loans. In addition, institutions must engage in a time-consuming manual process to transmit and receive data that involves downloading and uploading information to and from EDExpress and expEDIte, the Department's communications software package. Further, the Department has provided software designed primarily for IBM-compatible hardware; institutions with MacIntosh computer hardware are required to correct the software resulting in extra processing time and steps for these institutions. However, the Department has announced plans to implement the necessary improvements.

The Advisory Committee has developed four systems design and implementation recommendations. The Department should:

- *Create a comprehensive system design based on the latest technology that addresses current shortcomings in FDSLP operations.*
- *Make key changes to the current FDSLP processing system that assure program integrity to prevent disbursements from multiple institutions and overawards.*
- *Reassess the FDSLP's dependence on the National Student Loan Data System and clarify a contingency plan in the event that the system cannot perform the functions originally anticipated in a timely fashion.*
- *Modify the PC software and administrative procedures to minimize complexity and workload for institutions.*

ADMINISTRATIVE STRUCTURES AND PROCESSES

The Department successfully established critical administrative structures and processes to implement and maintain the FDSLP. Its activities in this area included:

- Handling management and staffing needs;
- Conducting the timely recruitment and selection of appropriate institutions for the AY 1994-95 FDSLP cohort;
- Beginning the recruitment and selection process for the AY 1995-96 institutional cohort;
- Promptly issuing task orders for training in AY 1994-95 and AY 1995-96; and
- Providing certain communications and customer services.

The Department addressed management and staffing needs by assembling a management team, known as the Direct Loan Task Force, to lead implementation of the FDSLP. It also arranged to hire consultants and permanent staff to assist with internal program operations.

The Department selected the first cohort of institutions by November 15, 1993, choosing 104 institutions from over 1,100 institutional applicants. The first cohort meets OBRA's target of five percent of FY 1991 FFELP volume (approximately $730 million). Large public institutions provided the anticipated majority of the AY 1994-95 volume. Eighteen public institutions represent an estimated 67 percent of the volume.

The Department also moved quickly to select the second cohort which will begin lending in AY 1995-96 by designating eligible institutions that applied, but were not selected, for the first cohort and by accepting additional applications on a rolling basis. To date, 1,174 institutions have been named for the second cohort, representing a reported total loan volume of more than 30 percent of FY 1991 FFELP's volume. The AY 1995-96 target is 40 percent.

The Department was prompt in issuing task orders to produce a training program for the first cohort on program specifications and software operation. The tight implementation schedule for the FDSLP affected the development of the workshops, which began in January 1994. Training had to be divided into two modules requiring institutions to attend two sets of workshops since cash management procedures and software were not ready until April 1994.

The Department recognized the importance of communications with institutions by initiating a customer service and technical support system that included making the Direct Loan Task Force highly visible and accessible. As a service to institutions, the Department also developed loan counseling brochures and videos.

The Department effectively put important administrative structures and processes in place in a very short period. However, the Advisory Committee finds that improvements are needed in *training* and *communications* to facilitate institutional participation.

The Department conducted FDSLP training late in the AY 1994-95 award cycle and employed limited training techniques. The Department scheduled training workshops for AY 1994-95 to extend from January to April 1994, thus providing important information too late for institutions that began packaging early in the calendar year. The Department has responded to feedback from institutions and will begin initial training of the new institutions in July 1994. However, the Department plans to maintain the original January through April schedule for up-date training.

The Department relied on printed materials distributed to trainees at the workshops from which instructors very often read aloud. Although the workshops provided hands-on training for the software, these sessions were often too rushed for trainees to acquire the experience they needed. The challenge of providing meaningful training for AY 1995-96 is considerably greater because the Department will be bringing as many as 2,000 institutions into the FDSLP.

The Department's ability to communicate effectively about the FDSLP has not been consistent, creating difficulties for both FDSLP institutions and institutions considering participation. The Department had established an electronic bulletin board to network FDSLP institutions with the Department. The project suffered from contract problems, became inoperable soon after being brought on-line, and could not provide the communication services expected in advance of AY 1994-95 implementation. The Department apparently did not have an adequate backup plan for disseminating information when the electronic bulletin board did not function. However, the Department subsequently produced a series of periodic bulletins for institutions and recently made the electronic bulletin board operational.

Institutions considering participation in the FDSLP also had trouble obtaining information. The Department did not provide regular mailings about the program and did not share technical materials. Institutions could request training manuals from the Department's Public Inquiry Contractor (PIC); however, the Department did not inform schools of this availability. Although the Department is working on the problems, continued inability to provide information about the FDSLP quickly and easily could reduce institutional interest in the program.

The Advisory Committee proposes two recommendations for administrative structure and processes:

- *Improve the timing and the techniques used for institutional training.*
- *Improve communication between the Department and institutions currently participating in the FDSLP as well as institutions considering participation.*

A compilation of the Advisory Committee's recommendations for the FDSLP appears in Appendix A.

FEDERAL FAMILY EDUCATION LOAN PROGRAM

The Higher Education Amendments of 1992 and the Omnibus Budget Reconciliation Act of 1993 incorporated provisions to streamline and simplify the Federal Family Education Loan Program and to achieve significant cost savings. The streamlining and simplification provisions consisted of requiring a common FFELP application and revising the FFELP's financing structure over time to encourage a reduction in the number of lenders and a consolidation of guaranty agencies.

Despite concerns about the stability of the FFELP through the FDSLP implementation, the program has remained healthy. In FY 1994, the FFELP experienced a significant growth in loan volume as a result of expanded loan limits enacted by the Higher Education Amendments of 1992, as Exhibit 2 indicates. The substantial increase in loan volume has had the effect of reducing the impacts of OBRA's modifications to the FFELP's financing structure that, for 1993-94, included: multiple disbursements of PLUS loans; lender payment of a .5 percent lender origination fee; payment of a monthly fee to the Department by Federal Consolidation Loan holders, based on the volume of their portfolios of these loans; and claim payments to lenders of 98 percent.

The effects anticipated from the statutory provisions also have been minimal not only as a result of increased loan volume, but also because other major changes to the program, such as decreased subsidies and expected additional volume losses to the FDSLP, will not occur until July 1994 and July 1995.

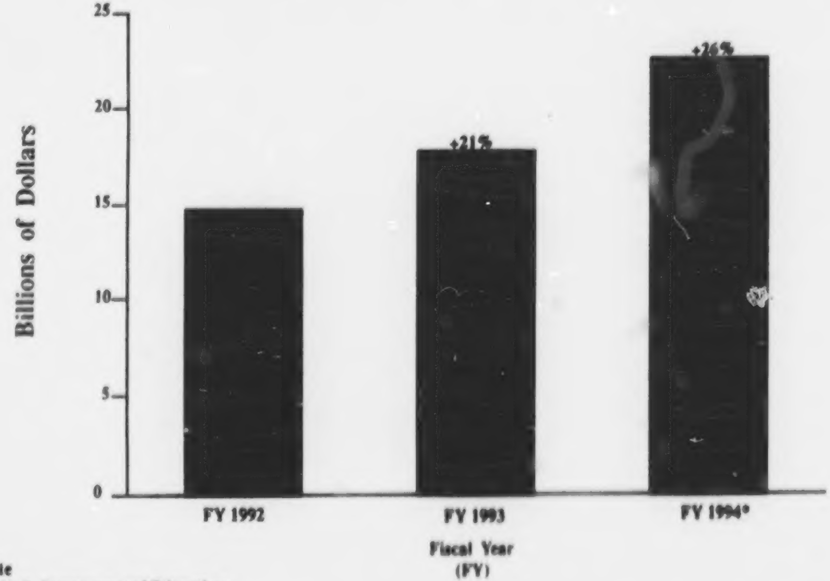
The Department addressed the transformation of the FFELP by implementing the following initiatives during AY 1993-94 to avoid a possible collapse of the guaranty agency system:

- Oversight of the orderly mergers process of certain guaranty agencies;
- Formation of a Transition Task Force and efforts by the Guarantor and Lender Oversight staff to ensure the stability of the guaranty agency system; and
- Creation of a Transition Guaranty Agency to deal with guaranty agency closures.

The Department oversaw the merger of the Puerto Rico Higher Education Assistance Corporation with the Great Lakes Education Loan

Exhibit 2

Impact of the Higher Education Amendments of 1992: Increase in FFELP Loan Volume FY 1992-FY 1994



*Estimate
Source: U. S. Department of Education

Corporation, with other mergers likely to take place in the coming years. The Student Loan Fund of Idaho ceased operation on June 30, 1994, and has merged with Northwest Education Loan Association. The Maryland Higher Education Loan Program, which state legislation abolished effective July 1996, is currently seeking an agency with which to merge. The Mississippi Guaranteed Student Loan Agency also will merge with an undetermined agency.

To facilitate orderly mergers, the Transition Task Force began visits to five of the most financially stable guaranty agencies to assess their capacity and willingness to assume other agencies' portfolios. The Transition Task Force also planned visits to agencies that probably cannot survive another five years to obtain from each a realistic assessment of their solvency and to provide them with an opportunity to consolidate with stronger agencies. In addition, the Guarantor and Lender Oversight staff obtained reports on individual institutional loan volumes held by each guarantor, giving the Department data to predict any agency's loss of volume when an institution chooses to participate in the FDSLP.

Other oversight activities involved closer scrutiny of guaranty agency activities during AY 1993-94. The Guarantor and Lender Oversight staff served notice to the Education Assistance Corporation of South Dakota of the Department's intent to terminate its agreement based on significant administrative irregularities, an action that the agency is appealing. It also required one guaranty agency to restore four million dollars to its guaranty agency reserves that were inappropriately spent on state scholarships. In addition, the Department used the negotiated rulemaking process to determine a common formula for establishing guaranty agency reserve levels for all future measures of guarantor solvency with minimum levels to be enforced beginning in 1995.

The Department also undertook the unprecedented action of establishing the Transition Guaranty Agency (TGA). TGA is designed to manage an insolvent agency until another guaranty agency is able to assume the portfolio. The existence of TGA increases the options available to the Department and strengthens its position in discussions with guarantors.

The Advisory Committee's examination of the FFELP during AY 1993-94 was limited by the phased implementation of program changes and by lack of access to Departmental data concerning the financial health of guaranty agency system and lender-of-last-resort agreements. Despite these constraints, the Advisory Committee finds that the

FFELP shows signs of stability, but believes that the Department must address shortcomings in its approach to avoid future problems. These shortcomings are in the areas of *monitoring lender withdrawals and changes in lender policies*, *ensuring lenders-of-last-resort*, and reassessing the viability of the *National Student Loan Data System*.

The Department has not established a system to monitor significant changes in lender FFELP policies and lender withdrawals from the program. Access to loan capital does not appear to be in jeopardy as evidenced by the increase in FFELP volume in FY 1994. While smaller banks may be leaving the program, only one major lender--NationsBank--has announced a decision to withdraw. However, the Department believes that FFELP capital will remain in ample supply. Consequently, it has not established a systematic mechanism to monitor lender participation or loan access. This could leave the Department unprepared for market shifts in lender participation and delay delivery of loan funds to students as institutions search for alternate lenders.

Lender-of-last-resort programs do not appear to be available to all students. Congress clearly intended that lenders-of-last-resort be available to all students either through the Student Loan Marketing Association (Sallie Mae) or the guaranty agencies. The Department entered into a $200 million agreement with Sallie Mae during the second quarter of FY 1994 to assure unimpeded access to lender-of-last-resort loans. Amid sporadic reports from the financial aid community of access problems, especially for proprietary schools, the Department has not shared details of its lender-of-last-resort plans or the states that have approved programs. However, anecdotal information suggests that a number of states do not have operational programs because guaranty agencies are concerned about the Department's policy to count defaults from these loans against reinsurance trigger rates, even though the loans themselves are reinsured at 100 percent.

The National Student Loan Data System has yet to become operational. Congress authorized NSLDS in 1986 to serve as a centralized source of information about borrowers' indebtedness and as a management tool to oversee the FFELP. The reasons for delay in implementation are twofold. First, the Department has grafted additional functions to the project so that the vast amount of data now needed to operate the system potentially threatens its viability. Second, some required data are not readily available from the guaranty agencies, which will have to rely on lenders for data at a time when the transition to the FDSLP and changes to the FFELP are likely to result in guarantors and lenders leaving the program. Also, the quality of the data is questionable given historical problems with tape dump data provided by guaranty agencies to the Department.

Once NSLDS does become operational, the transmission of the amount of data necessary to maintain the system is likely to reduce its capacity for lenders and institutions to query for information. This may mean that the system will not be able to perform certain functions, possibly for years, such as processing Student Status Confirmation Reports and financial aid transcripts. In this regard, the Department's development of NSLDS was not conducted in the context of broader delivery system issues; nor has the Department created a contingency plan for the interim, which could include employing existing options.

The Advisory Committee proposes the following recommendations for improving the Department's oversight of the FFELP. The Department should:

- *Develop a system to monitor lender withdrawals from the FFELP and changes in FFELP lender policies that can affect access to loan capital.*
- *Ensure that a lender-of-last-resort is available to all students.*
- *Reevaluate fully the planned FFELP dependence on the National Student Loan Data System to perform loan and delivery system functions, and develop a contingency that employs existing options.*

In addition, the Department should take administrative steps to implement the Advisory Committee's recommendations to simplify further the FFELP for students. The Advisory Committee's recommendations resulting from the Loan Simplification Study provided concrete steps that could be taken to simplify the program. Streamlining application documents and processes, minimizing the number of guarantors and lenders, and standardizing guarantor and lender policies should be considered as instruments of program simplification.

Appendix A contains recommendations for the FFELP in combination with its recommendations for the FDSLP.

APPENDIX A

RECOMMENDATIONS FOR THE FEDERAL STUDENT LOAN PROGRAMS

FDSLP

Program Design and Implementation Activities

- *Ensure that FDSLP disbursement rules coincide with the Pell Grant and Campus-Based programs.*
- *Ensure identical terms and conditions between the FFELP and the FDSLP by establishing long-term solutions to certain deferment problems, such as those affecting borrowers participating in medical residencies.*

Systems Design and Implementation

- *Create a comprehensive system design based on the latest technology that addresses current shortcomings in FDSLP operations.*
- *Make key changes to the current FDSLP processing system that assure program integrity to prevent disbursements from multiple institutions and loans in excess of statutory limits.*
- *Reassess the FDSLP's dependence on the National Student Loan Data System and clarify a contingency plan in the event that the system cannot perform the functions originally anticipated in a timely fashion.*
- *Modify the PC software and administrative procedures to minimize complexity and workload for institutions.*

Administrative Structure and Processes

- *Improve the timing and the techniques used for institutional training.*
- *Improve communication between the Department and institutions currently participating in the FDSLP as well as institutions considering participation.*

FFELP

- *Develop a system to monitor lender withdrawals from the FFELP and changes in FFELP lender policies that can affect access to loan capital.*
- *Ensure that a lender-of-last-resort is available to all students.*
- *Reevaluate fully the planned FFELP dependence on the National Student Loan Data System to perform loan and delivery system functions, and develop a contingency that employs existing options.*

APPENDIX B

LIST OF MEMBERS AND STAFF
Advisory Committee on Student Financial Assistance
Current Members by Class of Appointment

Class of 1994
(Term expires September 30, 1994)

Dr. Robert E. Alexander
Chancellor
University of South Carolina-Aiken
Aiken, South Carolina 29801
(Secretary of Education appointee)

Mr. Robert A. Kraig
Madison, Wisconsin 53703
(Secretary of Education appointee)

Dr. William C. Hiss
Vice President for Administrative Services
and Dean of Admissions
Bates College
Lewiston, Maine 04240
(U.S. Senate appointee)

Dr. Joseph L. McCormick
Executive Director
Alaska Commission on Postsecondary Education
Juneau, Alaska 99801-7109
(U.S. House of Representatives appointee)

Class of 1995
(Term expires September 30, 1995)

Mr. Stephen C. Biklen
President
The Student Loan Corporation
Pittsford, New York 14534
(House of Representatives appointee)

Ms. Elizabeth M. Hicks
Coordinator of Financial Aid
Harvard University
Cambridge, Massachusetts 02138
(Secretary of Education appointee)

Dr. Stanley Z. Koplik
Chancellor
Commonwealth of Massachusetts
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Ms. Vernetta P. Fairley
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University of Southern Mississippi
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(Secretary of Education appointee)

Class of 1996
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Ms. Lynn M. Fawthrop
Director of Financial Aid
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Mr. Thomas A. Butts
Associate Vice President for
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Mr. Fernando de Necochea
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Brown University
Providence, Rhode Island 02912
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Advisory Committee Staff

Dr. Brian K. Fitzgerald
Staff Director

Ms. Tracy D. Jones
Staff Secretary

Dr. William J. Goggin
Staff Economist

Ms. Ardena N. Leonard
Research Assistant

Ms. Hope M. Gray
Staff Assistant

Ms. Debra L. Schweikert
Associate Director

Chairman HOEKSTRA. Mr. Reyer.

STATEMENT OF OTTO REYER, ASSOCIATE VICE CHANCELLOR AND DIRECTOR OF STUDENT AID, UNIVERSITY OF CALIFORNIA, IRVINE

Mr. REYER. Thank you, Mr. Chairman, Members of the committee. I'm Otto Reyer, and my position is Assistant Vice Chancellor and Director of Financial Aid at the University of California, Irvine. I've been at UCI for 22 years.

During those 22 years, I have seen most of the current financial aid programs come into existence and some go out of existence. My testimony today was to focus on the direct loan program, and most of the people that were here have described exactly what is occurring at the University of California, Irvine. My testimony goes into a little more detail than that in terms of the actual process for a student, but I'd like to just give you a little history.

Fifteen years ago I approached a bank here in the United States to see whether or not we could arrange for them to transfer dollars directly to the University, and I would FedEx them the applications. I would guarantee, if the guaranty didn't come through the agency, that we would buy back the loan. I'm still waiting for a response from that bank, because I was looking for a way to get funds to students, because the program was symptomatically broken.

We could not get funds in the hands of students. Twelve years ago, I discussed with the University whether or not we should become a lender. We could lend to graduate and professional students. If we could build a program that worked for graduate and professional students, maybe we could lend to undergraduates in this program.

That didn't work out because of capital, but I've tried all different ways to try and make the process work for students, the reason being it takes under the current program with FFELP for us, when we were in it, anywhere from 30–45 days from the start of the process to get the student the money, and we were losing students during the process.

At one point in 1993, in the fall of 1993, we had to issue 1,100 emergency loans so students could pay fees, because the FFELP check wasn't there. Now I understand, it has gotten a lot better, and I think that's wonderful; because the winner in this game is the student.

It is not the FFELP program. It is not the Department of Education. That's not why all these people are here. It's trying to get the student the money so they can go to school. If we don't have that, we don't have the education. We don't have the things Congressman Goodling talked about. We don't have the things Senator Simon talked about. They're not there.

Let me give you two examples. We have a Regent's Scholar student, our highest honor, comes in and walks on the basketball team, makes the team, is wonderful, biological—biology student, who goes through school, does wonderful, plays basketball. His senior year, his fifth year, he was a redshirt for one year and was studying for the MCATs.

He then decided that his fifth year, because he didn't qualify for the Regent's Scholarship any longer, that he wanted a loan, and he came into my office, and he said, can I get the loan this year? I said, what do you mean? He said, well, if I go through the normal process, the story I heard was it's going to take 30–45 days to get the loan.

I said, no, we're in a new program. We can get you the loan within 48 hours. He said, okay, I'll take it, he said, because otherwise I'm going to have to borrow from my friends. That student was just accepted at Stanford Medical School. Those are the kind of differences we can make when we can service the student.

FFELP is doing that now. They are starting to move on different things that work to help students, and those are the important things that we're about that we need as tools in the financial aid offices.

Thank you very much.

[The prepared statement of Mr. Reyer follows:]

Otto W. Reyer

Assistant Vice Chancellor and

Director of Financial Aid

University of California, Irvine

Mr. Chairman and members of the Committee, I'm Otto Reyer and my position is Assistant Vice Chancellor and Director of Financial Aid at the University of California, Irvine. I have been at UCI for 22 years.

During those 22 years I have seen most of the current Financial Aid Programs come into existence and others go out of existence. My testimony today will focus on the Direct Loan Program and its comparison of our involvement with the Federal Family Education Loan Program (FFELP).

In the mid to late 1980's the California Student Aid Commission (CSAC) approached UCI to be in a pilot program of electronic access and input of FFELP loans to that agency for guarantee. This process was the pilot for the current electronic process used by CSAC.

Here is how the process worked:

1. Student completed a Free Application for Federal Student Aid (FAFSA).

2. The application would be processed by the private contractor for the Department of Education.

3. The results were electronically transferred to UCI.

4. UCI determined if the student qualified for the FFELP loan.

5. The student returned acceptance of the FFELP loan.

6. UCI transmitted (electronically) the data regarding the FFELP loan. (I would also state that we were one of 10 campuses using the electronic process. Other institutions had an additional step for students, in that they had to fill out a separate application and the Financial Aid office had a section that it had to complete.)

7. CSAC sent to the student's home address an application/promissory note.

8. The student then sent the application/promissory note to the bank.

9. The bank processed the application/promissory note and forwarded a check to UCI.

At the time UCI was in the FFELP Program, this was the most sophisticated processing of FFELP loans available through CSAC. There were times when students had no idea where their application/promissory notes and/or check were in this process. Once UCI sent the data to the CSAC, we were in the dark as to where the paperwork might be. Student's would come to our office, many who were very irate, trying to find their check. At times it took 30-45 days to locate where the loan was in the processing and if a student had to pay fees, UCI had to process an emergency loan. In Fall of 1993 we issued over 1100 emergency loans for students whose FFELP loans had not arrived at UCI.

I can't tell you the number of parents who called my boss or the Chancellor to complain about not having their parent loan to pay the cost of going to the University.

These calls and students coming to our office put a tremendous amount of stress on my staff. That stress was nothing compared to the stress that was put on the students and the parents.

Then came the advent of the Direct Loan Program. I will tell you up front that the thought of being able to process loans in our office was so exciting that we were the first University of California campus to support the concept of Direct Loans.

In describing how the Direct Loan Program works at UCI, the first five steps of the FFELP loan are the same for the Direct Loan. At UCI, with Direct Loans, the following happens:

1. The student is sent a Direct Loan promissory note from UCI.

2. The student sends the promissory note back to UCI.

3. The student receives the check.

As you can see, the process is tremendously simplified. Should the student or parent not receive the promissory note, we can instantaneously produce another note, have the student sign it and produce their check immediately if necessary.

Direct Loans work, they work for UCI, they work for the student, they work for parents, and they work for the United States Government. In the process of implementing Direct Loans, we have received great support from the Department of Education. In past years, that statement would have been an oxymoron. Today it is not. If you call the Department, they will pick up the phone and answer you in a polite and courteous manner. They even return phone calls.

Another key element with Direct Loans, is the Department has contracted with a private corporation to run the Direct Loan Program. This private corporation, AFSA, is the same company that all the major secondary markets and banks use to service the FFELP loan program. When we call them with a question, and there have been questions, AFSA has been very responsive. In any pilot program, and UCI has been involved in most State and Federal pilots, there are going to be challenges. We knew this when we signed up for the Direct Loan Program. Every challenge we have faced has been solved. These solutions have come fairly easily. The three partners in the process (University, Department, AFSA) have worked well together. The Institutions that are coming onboard in year two of the Direct Loan

Program will face an easy transition into the Direct Loan Program.

The advent of the Direct Loan Program has given UCI the time to meet with students and counsel them on the appropriateness of getting into financial debt. We would not have the time if we were still calling banks, guarantee agencies and sometimes even the post office to locate a FFELP loan.

Thank you for allowing me to testify and let me invite all of you to visit UCI and see how the Direct Loan system works at my Institution. Should you have any questions I would be more than glad to answer them.

Chairman **HOEKSTRA**. Thank you very much to the panel. It's kind of interesting. Does Maine still provide through the private sector student loans?

Mr. **PIERCE**. Does it what?

Chairman **HOEKSTRA**. Does Maine—You said that 20 years ago or whatever, before the Federal Government got into the business—Is that still part active in the marketplace?

Mr. **PIERCE**. Actually, when the guaranty agency came into being in 1965 after the Act, the private sector took that money and turned it over to the guaranty agency as part of the money. So it continued on, but they didn't run it anymore. They let the State agency run it.

Chairman **HOEKSTRA**. Listening to all the testimony, I'm hearing—I don't think there is any disagreement that the intent is to develop as effective and as efficient system as possible. You know, the last thing we want to do is keep kids out of schools because of their inability to get a Federal loan.

If we can—banks can process car loans in 48 hours or 24 hours, and now I hear mortgages in west Michigan at least are going to be processed in something like less than five days or three days, it shouldn't be all that much more difficult to process a student loan.

I hear that, whether you're in either one of the programs right now, both programs appear to be working significantly better, one than what was in place before and one that was working—maybe than what it was working three or four year ago. The only ingredient or the only change appears to be perhaps that we introduced competition into the system.

I'm not sure where that leads me personally, because I hate for the Federal Government to be running or somehow co-sponsoring two different programs in the sake of competition. It's an interesting concept, but I'm not sure how affordable that is in the long run for us to do.

What kind of—We talk a lot about the students. What kind of risk did any of the institutions—you know, any of the colleges—have with either one of the programs? I mean, there is no cost involved other than, what, the level of service that you decide to provide to your students?

Ms. **HOOYMAN**. What we have found is actually reduction in costs for administering under direct loans. In terms of liabilities, we see no greater liability under the direct lending program than we do under the FFEL program. Does that answer your question?

Chairman **HOEKSTRA**. Yes. I mean, there is really—That's the level of—You have administrative cost. You have the level of service that you can provide.

Ms. **HOOYMAN**. Actually, better service has come about as a result of the direct lending program. As mentioned in my testimony, we've really been able to redirect our staff to do other student service initiatives that are really better serving our students than doing a lot of check chasing. So that's been a real enhancement for us.

Chairman **HOEKSTRA**. Dr. Reyer, were you going to say something?

Mr. **Reyer**. I would just say that, the first student to come in with a promissory note was a medical student this summer, and he came into my medical school office and said, here's a promissory note, now when do I get the check? We said, we'll have your check in about 48 hours, and he got into an argument with the technician because he just thought he had had enough lies from the financial aid office on these loan things and did not believe her.

Because of the direct loan program, she was able to put it in, get it through Accounting, and get the student the check. Now we've built a system that they know—students know that it's 30–45 days to get the check under the old program, because of all the different things and maturations it has to go through, and we're talking about 48 hours.

That's a gigantic difference with the direct loan program. We have the same liabilities under both programs, as far as I'm concerned, right now.

Ms. **Ryan**. I don't know if that's completely true. I really can't address the promissory note issue. I just know that under the FFEL program I have no liabilities on promissory notes on the program, and I understand that there are not significant liabilities for schools, but failure to properly execute a note would be a problem, I would think, under direct lending.

Ms. **Hooyman**. But there are also tremendous liabilities in check handling. That was probably one of the biggest liabilities we carried institutionally, was that of handling 4,000 checks and how we handled that and when we disbursed it, and if we disbursed it late, did we do it right. That's where our phone calls were really concentrated. So there were great liabilities in check handling.

Ms. **Ryan**. New initiatives as well—I mean, the ELM system can provide for automated check deposit. There's an awful lot of innovations that are out there that would mirror direct lending. I mean, a number of the same efficiencies that are being brought to campuses under direct lending are available now under the FFEL program with some of these new innovations.

Chairman **Hoekstra**. My time is up. I will yield to Mr. Scott.

Mr. **Scott**. Mr. Chairman, I just have a couple of questions. I think it was Dr. Ryan who mentioned virtually paper free transactions. Can you describe the old system and the new system in terms of the paperwork?

Ms. **Ryan**. Well, under the old system a student would bring in a paper application for a student loan and turn that in. We would process that separately from the rest of the financial aid programs that we would be administering, and then that paper application would get certified, sent to a bank, then sent to get a guarantor from the guaranty agency, sent back. Ultimately a check would arrive at the campus, and then the check would be disbursed to the student.

Under the new method of processing Federal agency loans, we're not quite where we want to be with respect to electronic application means. We still have to have a separate application, common application emanating from the lenders, but there's been tremendous changes in the way in which we actually process.

It's folded into our regular student aid processing, the other Title IV programs we administer. Data is electronically shipped to a service bureau. The guaranty is obtained. Everything is done completely electronically, and ultimately a master check arrives at the campus, which is then deposited to individual student accounts. So we don't have the same check problems that we used to under the old method of dealing with FFEL. So it's a very different process than it was.

We still have the impediment, though, of not being able to use FAFSA to apply for the loan. That's still an impediment for us.

Mr. SCOTT. Use what?

Ms. RYAN. Use the Free Application for Student Aid. We still have a separate process for that.

Ms. HOOYMAN. I think one real impediment that remains is just the fact that you have the various layers of bureaucracy, and that is why we opted for direct lending, because again when we are looking at direct lending, we are controlling it entirely in house.

Almost any model that includes lenders and guarantors will mandate that the school has to do some type of communication with those agencies, those outside sources, if indeed there is a problem of any kind for that student. It's going to be very difficult to operate in a vacuum without their input, if there is something wrong.

That's been—For Hope College, that's been the real enhancement for my student population. When that student comes in with a question, I immediately have an answer for him. So I think you can see here the variety of needs at institutional levels, and it's really helped us tremendously.

May I add one other comment on a subject—I know that there are concerns in the area of repayment. I heard Mr. Goodling bringing that to bear. I think it's a misnomer to think that institutions are not highly concerned about the quality of repayment and the collection efforts made on behalf of their students.

When we have graduates coming out of Hope College, it's extremely important that we have good rapport with those students. We want them to be good alumni with our institution, and that was another major reason we went into direct lending, so that we had one servicer dealing with our students; because many of our students and parents were very frustrated that their loans were being sold.

I would have parents who were on my staff at my college coming in saying, I have a Plus loan, and I don't even know who is holding it; I don't know where it is; I don't even know who to pay. That was why we wanted to get away from in direct lending.

Mr. SCOTT. Who do they pay with you?

Ms. HOOYMAN. Pardon?

Mr. SCOTT. Who do they pay?

Ms. HOOYMAN. The servicer, the Federal Government, one servicer throughout the life of the loan. That will be AFSA Corporation, all of the collections occurring through AFSA.

Mr. SCOTT. How much contact do you have in this process with the Department of Education?

Ms. HOOYMAN. My contact has been really stellar this year in terms of any problems we had. My staff would call in if we had any questions or problems. We had immediate responses within anywhere between 24 and 48 hours. So it's been excellent in any interactions we've had with them or with the servicers.

Mr. SCOTT. Do you have confidence that the Department of Education can respond like that when you go to 100 schools to 2,000 schools?

Ms. HOOYMAN. I really believe they are committed to do that. They have really expanded their staffing. They have assigned account managers out to all of their regional offices to help us regionally to bring up the program. So I think that will be a real enhancement for us.

Mr. SCOTT. So you're not concerned about their ability to respond?

Ms. HOOYMAN. To date, I have not been. I see nothing to give me cause for concern in that area.

Mr. SCOTT. Any other comments? Thank you, Mr. Chairman.

Chairman HOEKSTRA. Phyllis, I might just ask you to look to your left to see if there might not be any concern about it, because I was going to ask Dr. Ryan. It appears that—and Mr. Pierce also mentioned it in his testimony, that—You know, I think Mr. Pierce said something like, you know, let's have the Education Department treat both programs fairly and with the same level of support.

I think Dr. Ryan mentioned in her testimony the ELM program which right now—Is it correct that the Education Department is prohibiting you from using this program?

Ms. RYAN. No, that's not exactly correct. What we are precluded from using is an electronic application for financial aid, which the ELM project fully envisions. They have developed a disk application that looks exactly like the paper FAFSA form used by the Department of Education, but we are precluded from using that because of statute.

Now I can't speak for ELM and where they may be in their deliberations with the Department, but I do know that we would love to have some better cooperation there with respect to being able to use some of the technology that the private sector is developing.

Chairman HOEKSTRA. You said by statute. You mean it's our—It's a Congressional—It's our problem or it's a rule and regulation out of Education Department.

Ms. RYAN. Gee, somebody help me with the right term.

Ms. FAWTHROP. It's statutory.

Chairman HOEKSTRA. Statutory. Well, I'm sure Mr. Scott will join me in offering that in a bipartisan way on the first day of corrections day, that perhaps we can correct that and, you know, have the—get the Education Department out from some rules and regulations that we have imposed on them. Yes, go ahead.

Ms. FAWTHROP. Mr. Chairman, certainly, the goal here is to make the process for financial aid through the Federal system as simple as possible, but I would caution this committee in that, if you're going to look at electronic applications, that we look at not having duplication and proliferation of competing forms.

Chairman Goodling was a very strong supporter of ensuring that students had the ability nationwide to apply for financial aid. The Department of Education is working on ways in which making that Title IV delivery system process even easier in terms of allowing them to apply electronically. I think the committee would caution you about having proliferation of the Federal system once again in terms of the delivery of the Federal Government's programs.

Chairman HOEKSTRA. Thank you.

Mr. REYER. The concern here more than anything else is that all of a sudden we get 30 and 40 page applications. Now I'm not saying ELM wants to do that. I know they do not. Okay, but there are companies and people out there who could have applications that could end up being very, very long and complicated and pushing students out of the process.

That's the reason it was put into statute, because some applications were four or five pages long with 16 pages of instructions, and all of a sudden, students and parents just threw it up in the air and said, hey, you're going to work. Forget this college stuff.

Ms. FAWTHROP. The other point, Mr. Chairman, is that the statute requires the free Federal application to be used for applying for Title IV. Where the Federal Family Education Loan Program is getting into the glitches is there's still a separate loan application being required for that program.

If we could lift that statute of that requirement, then everyone could use the free Federal application to apply for all Title IV aid, regardless of whether it was a direct loan or a Federal Family Education Loan. So that's the statute that I would urge you to look at in terms of having a separate loan application.

Chairman HOEKSTRA. Thank you. I'm not sure what I said to make you believe that I might be in favor of a 16 or 30 page form. I want to make everything as easy for students. I just want—and I recognize this emphasis on students, but at the same time it's a lot of money that somehow we have a responsibility to monitor, to track, to invest wisely and, hopefully, get some return on it and, at least in the student loan portion, have it repaid back for us.

That's what we're trying to do and put together a good system. So I appreciate this panel in providing us with this testimony and helping us to evaluate different options to be able to do that.

So the committee will be adjourned. Thank you very much.

[Whereupon, at 4:12 p.m., the subcommittee adjourned subject to the call of the Chair.]

[Additional material submitted for the record follows.]

PURDUE UNIVERSITY

DIVISION OF FINANCIAL AID

ADVISORY COMMITTEE ON STUDENT FINANCIAL ASSISTANCE
Institutional Imperatives for FFELP Simplification
April 11, 1995

Panel Presenter: Joyce Hall
Purdue University
West Lafayette, Indiana

I would like to thank you for the opportunity to make comment about the family federally-insured loan program. I participated in the implementation of an automated Guaranteed Student Loan program in our office at Purdue in the early 80's and felt quite prophetic in saying at a presentation on FFELP: "Either we manage the FFELP or it will manage us."

I would like to provide information on my campus. Purdue has 70 percent in-state and 30 percent out-of-state students with an enrollment of 34,000. Seventeen thousand (17,000) Stafford Loans have been processed this year. Dollars are $50 million in Stafford and $12 million in Parent Loans for a total of $62 million to date. Forty-two percent of undergraduates borrow and 27 percent of graduate students borrow. Average debt is $9,721 for undergraduates graduating in 1994 and $14,825 for graduate students.

1102 SCHLEMAN HALL OF STUDENT SERVICES • ROOM 305 • WEST LAFAYETTE, IN 47907-1102

In today's college environment we are participating in business process redesign; redefining our students and families as customers with all the rights and privileges that accrue to that designation; experiencing dramatic increases in our student loan borrowers; and expected to gain efficiencies through technology that will allow a more streamlined entry into the university. The focus of today's panel fits very well with the concept of business process redesign. Of course, my comments today are by necessity from an institutional perspective of what would make FFELP better for us and for our students and parents.

FFELP DELIVERY SYSTEM **Family Federal Education Loan Program**

1. I support the concept of allowing students and parents to apply for the FFELP via the FAFSA process. Schools could streamline the process if all data for a student application was received at one time via the FAFSA. The school could send all loan data electronically to one data destination utilizing a common format. The common data destination could then format according to the needs of the servicer, guarantor, or lender.

2. It is critical that electronic processes use a common format for schools. Large public universities still process loans from all over the country from all guarantors and a large number of lenders. A current model being discussed called "common line" which I understand is orchestrated by Sallee Mae and USA Group will allow a school to send data via the USA Group WhizKid process. I believe approximately 30

guarantors have agreed to use this new process. As I understand, this process will allow 95 percent of my loans to be electronically transmitted from the current 75 percent.

The "common line" destination will format the school data and transmit the data to the different guarantors utilizing the format they need. I believe all guarantors should participate in a common destination allowing schools to utilize one format for all loan transmissions. This would allow schools to transmit 100 percent of loans electronically.

3. It is imperative that all phases of loan corrections, refunding, and electronic fund transfer (EFT) be developed to allow schools to electronically send this data to lenders, servicers, or guarantors through a common destination point. One of the most cumbersome processes for the FFELP is the correction process and return of loan funds to the lender or servicer. In many cases, all loan funds must be returned to the lender with the student having to complete a new application.

Very often loan correction letters are not received by the lender, servicer, or guarantor in time to stop and correct the check. As long as the school could transmit new eligibility for a lesser loan, only the difference should be returned with data sent electronically confirming the new eligibility.

4. Forms, policy interpretations, and general processes should be standardized. Lenders, guarantors, and servicers can create other ways to differentiate their services. Since the FFELP is a federal program, schools and students should not be confused by varying interpretations of a single policy. As an example, a large guarantor has recently told Purdue they will not accept our computer-generated borrower information that is required as part of exit counseling even though all the data they need is reported. Schools should not have to deal with these types of issues in today's environment.

Presently we still receive different interpretations of policy from different guarantors. I believe the Department of Education must reassume the role to provide "Dear Colleague" assistance to schools, lenders, and guarantors to clarify FFELP policy issues which are causing confusion in the community in a timely manner.

PROGRAM FEATURES

1. SINGLE SOURCE BORROWING -- I know that many people are advocating single source borrowing for students. At a large school, I cannot monitor which lender a student is utilizing. It is impractical and would add a level of bureaucracy. I think we can encourage use of one lender. Students should be able to consolidate their loans at the end of their loan period with one servicer, guarantor, or lender to alleviate this problem.

2. INCOME CONTINGENT LOAN REPAYMENT – Students under FFELP and Direct Lending should have the same repayment options. It should not necessarily require that the student consolidate under Direct Lending to receive this option.

3. As most of us agree, much of the complexity of the FFELP program comes from the regulations and interpretation of regulations. Of all the aid programs, this program seems to change daily through continuing interpretations of policy. I urge serious consideration be given to streamlining the regulations. (All the technology available cannot streamline a round program through a square hole.)

As we look to streamline the FFELP, I believe we should not miss the opportunities currently being implemented. Discussions regarding the National Student Loan Data Base, a new delivery system, and the Student Loan Clearinghouse seem to be occurring without much cross talk among the players. I would urge that these efforts include cross functional members and representatives of differing types of institutions so the breadth of the development can be understood and duplication of effort can be avoided. It is imperative that the department utilize business process re-engineering principles to reorganize the data flow before designing complicated system support.

Testimony of

Kathy Cannon
Vice President and Manager
Student Loan Center
Bank of America

and

Chairman
ELM Resources

on behalf of

Consumer Bankers Association

before the

Advisory Committee on Student Financial Assistance

April 11, 1995

Good morning.

I appreciate the opportunity to meet with you to discuss the perspectives of lenders on the Federal Family Education Loan (FFEL) Program. In my remarks today, I will address three aspects of the FFEL program, which I hope will be of interest to the Advisory Committee.

First, I want to share with you my thoughts on a major industry initiative designed to improve efficiency in financial aid processing called Educational Loan Management (ELM).

Second, I would like to address briefly the perceived difficulties the student loan industry has had in securing cooperation from the Department of Education on working towards FFEL program improvements and innovations.

Finally, I will share with you some observations on student loan repayment options and the degree to which recent different repayment opportunities work to the benefit of student borrowers.

ELM

I would first like to turn to an initiative which I believe addresses many of the loan delivery problems this Committee has identified in the Federal Family Education Loan Program. Our initiative is called Educational Loan Management, or ELM, and it both simplifies and standardizes the financial aid process. It is analogous to an ATM system, allowing standardized input and output while allowing the schools and borrowers to choose the financial aid "partners" (such as lenders and guarantors) they want. A graphic of the ELM Front and Back-end Data Flows is attached to my testimony, but I would like to share with you a very short walk through of the process.

The ELM electronic application is distributed to students directly by the financial aid office. Applications may also be made available through a broadcast system that allows students to access the ELM application via modem. There is no charge for applications through the ELM process.

The application contains a series of questions relevant to federal, state, and institutional financial aid applications. These questions are determined by the participating schools. The ELM application embodies an electronic version of the Free Application for Federal Student Aid (FAFSA). As this Committee knows, many in the financial aid community believe that universal availability of an electronic FAFSA would be a major step forward in maximizing student access to financial aid. I am aware of reservations some members of this Committee may have with the production and distribution of the FAFSA in electronic form. I would urge the Committee to fully explore this option and recommend solutions to legitimate concerns rather than forming a blanket conclusion that an electronic FAFSA is not viable.

After the student has completed the ELM application, signatures are collected on a label on the ELM diskette. Upon receipt of an application through ELM, the application can be processed on-campus or through the ELM Service Bureau. The ELM Service Bureau will pull off the data elements relevant to the FAFSA and transmit this information to the Department of Education via EDExpress in the prescribed ED format. The ELM Service Bureau will also pull out the institutional data and transfer it to the campus. It will also pull out loan data and hold it until, if and when, the school is ready to process the loan application.

Under this process, the campus will receive the federal data via EDExpress. The campus will collect documentation as set forth in regulations, determine the student's financial need, and award accordingly.

Through ELM, the lender will be notified electronically that a loan application has been received and will draw this information down from the ELM Service Bureau. The lender will obtain an electronic guarantee of the loan, generate the promissory note and obtain the student's signature. The lender will then notify the ELM disbursement agent that a loan is ready for disbursement. Disbursement of the loan will be made through electronic funds transfer (EFT), Automated Clearinghouse (ACH), or individual checks, as the school requests.

Madame Chairman, I believe this process represents a dramatic leap forward for schools and students. I hope this Committee will review the efforts of ELM closely and do all it can to promote the use of this process this year.

I also urge Committee members to review the more comprehensive description of ELM to get a better feel for the innovations and efficiencies that are brought forward by this new program. Bank of America and other lenders participating in the program are very proud of this innovation which was developed without one penny of federal taxpayer money.

Concerns Regarding Cooperation at the Department

In working on the ELM initiatives and discussing other program innovations being developed within the student loan industry, I have been discouraged by what appears to be an environment of non-cooperation at the Department of Education. Many participants in FFEL believe that the Department is dedicating inordinate resources to the implementation of the Direct Loan Program at the expense of working on improvements in FFEL, notwithstanding the fact that literally millions of students are likely to receive loans through this program for at least the next several years.

I urge the Advisory Committee to weigh in forcefully with the Department of Education to urge a higher level of cooperation with the student loan industry. I also believe that it would be appropriate for the Advisory Committee to monitor progress on various initiatives requiring Department of Education approval or cooperation.

Repayment Options: More Complex Than Necessary?

I now would like to turn to the issue of repayment options in the two federal student loan programs. As this Committee well knows, the Congress and the Department of Education have tremendously increased the varieties of repayment options available to students. As a lender concerned with maximizing loan repayment rates, the attention to this aspect of student lending, which is intended to avoid the incidence of student loan default, has been very welcome.

There are now no less than five different repayment plans available under the Federal Direct Student Loan Program -- standard 10-year amortization, extended repayment, income-sensitive repayment, income-contingent repayment, and graduated repayment. Some of us in the FFEL program have examined these options very carefully, from the perspective of how we might duplicate them in the FFEL program so as to address the concerns voiced by some educational institutions regarding comparability of terms and conditions. What we have found is that the actual impact on loan repayment amounts under these options are virtually identical, creating a question of whether all of the different repayment options now authorized are really necessary to provide the flexibility in repayment that is the goal of the new repayment plans.

As many of you know, the development of regulations for the income-contingent loan repayment plan through negotiated rulemaking was an arduous and controversial undertaking. Many in the school and lender communities questioned whether borrowers would be well-situated to make an informed choice about this option, given the attractive feature of loan payments set to correspond to the borrower's post-education income. The income-contingent repayment plan, however, has two major problems, which are dramatic increases in life-of-the-loan repayment, and loan forgiveness provisions that trigger an event of taxable income after 25 years. Both represent nasty surprises that will give borrowers a sense of being tricked or deceived. As you know, the regulations were subject to various changes in the course of negotiated rulemaking and have finally been promulgated in a form that still is troubling for many individuals.

As an individual involved in consumer credit for 17 years, I personally am troubled by the inclusion of negative amortization in the income-contingent loan repayment plan. Regardless of the extent to which borrowers are counseled on the life-of-the-loan interest, the actual numbers produced will remain a bitter surprise for a large percentage of borrowers. I also question whether we are doing borrowers a favor by reducing repayment amounts to a level that, in many cases, may be less than what the borrower can actually afford.

I also note that when income-contingent loan repayment is compared to the current option of loan forbearance, including zero payment loan forbearance, the same benefits, in terms of payment relief, can be provided to borrowers in a much more customized fashion. This fact has led some lenders and some schools to suggest that Congress should consider repealing income-contingent loan repayments altogether, relying instead on individualized borrower reviews, leading to personalized repayment plans.

Everything that I have said regarding income-contingent loan repayment may also be said about the graduated and extended repayment plans. Both of these plans are even more troubling than income-contingent loan repayment because of the absence of periodic checks on the borrower's ability to pay. Examples of loan repayment produced by the Department of Education show that in the case of a teacher with a starting salary of $30,000 who borrowed $35,000 to finance her undergraduate and graduate degrees, a 10-year standard repayment plan produces monthly payments of $414 with total interest paid of $14,700. Under an extended repayment plan of 20 years, the monthly payment would be reduced to $280, but total interest paid over the life of the loan would increase to $32,300. Finally, as a basis for this discussion, a graduated repayment plan under which payments increase every two years and are set on a 20-year repayment plan, initial payments would be $220 per month and would increase to approximately $400 near the end of the repayment term. Under this option, total interest paid would be $37,900.

This Committee should recognize these increased interest payments as bad education policy. First, the risk of the Federal Government is extended by exposing the loan to the contingencies of the borrower's death, permanent disability or financial inability to pay for a much longer period of time, notwithstanding the fact that the borrower may have absolutely no need for any repayment relief whatsoever.

More importantly, the extension of the repayment period inherent in the two additional options, as well as income-contingent loan repayment, discourages the borrower from saving for the college education of their own son or daughter. It also discourages contributions as an alumni to the school which the borrower attended. In both cases, this borrower behavior creates a need for additional student loan borrowing in the next generation. In no way can this be interpreted as sound education policy. In fact, the only beneficiaries of such borrower behavior are individuals who would like the Department of Education to grow in size and for individuals to be indebted to their government as a means of better controlling their activities.

Extension of repayment terms also extracts a high price from borrowers in terms of its effect on the ability to obtain other credit. Continued student loan repayment obligations mean that affected borrowers will be less able to finance a house or car, or even a small business. To the extent that the loan would have been repaid without an extended repayment period, this federal student aid policy will have only hurt the borrower.

Madame Chairman, I believe the concept of extending loan

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repayment only to the extent necessary to provide the borrower with the repayment flexibility needed to afford payments should be specifically endorsed by the Advisory Committee.

I also recommend that the Advisory Committee undertake, over the next year, a more comprehensive look at borrower repayment options with the goal of radically simplifying them and fully utilizing individualized counseling of borrowers. Also, use of the forbearance option as a substitute for some of these loan repayment options should be considered. While I believe that appropriate repayment relief should be provided to borrowers experiencing difficulty in meeting their loan repayment options, the Advisory Committee should recommend repayment options that avoid unnecessary extension of repayment terms beyond the standard 10-year repayment term that has been utilized in the student loan programs over the past several years.

It is important to note that over the last few years losses in federal student loan programs resulting from defaults have dramatically decreased. These decreases occurred notwithstanding the fact that the tremendous increase in loan repayment flexibility enacted in 1993 had yet to be implemented. The decreases in defaults resulted from better policing of schools, largely through the provisions of the Higher Education Act that terminate the participation of high default schools from the Federal Family Education Loan Program. Although similar termination provisions are not applicable to the Federal Direct Student Loan Program, I believe that continued progress could be made in reducing defaults without resorting to overkill on loan repayment options.

In conclusion, I would like to again urge this Advisory Committee to undertake a proactive role in monitoring the activities of the Department of Education with regard to the Federal Direct Student Loan Program and FFEL Program. Perhaps more importantly, the Advisory Committee must seek to wrest control of the student loan debate from parties that seek to politicize it. In this regard, the concepts of borrower repayment flexibility should be examined critically from the actual education policy consequences as opposed to how it sounds in a political speech.

The Bank of America and the Consumer Bankers Association would welcome the opportunity to work with the Advisory Committee or the Department of Education on reviewing these matters.

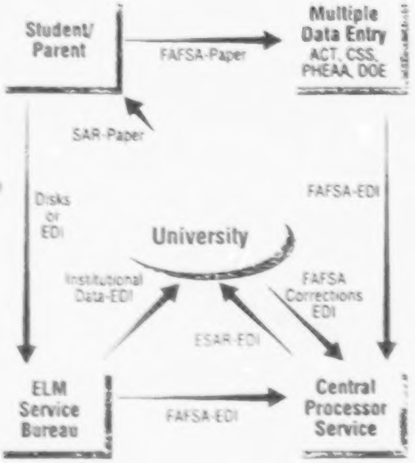
Madame Chairman, I would be happy to respond to any questions that you or other members of the Advisory Committee may have regarding my testimony. CBA thanks the Advisory Committee for its interest in our views on these important matters.

ELM Front-End Data Flow

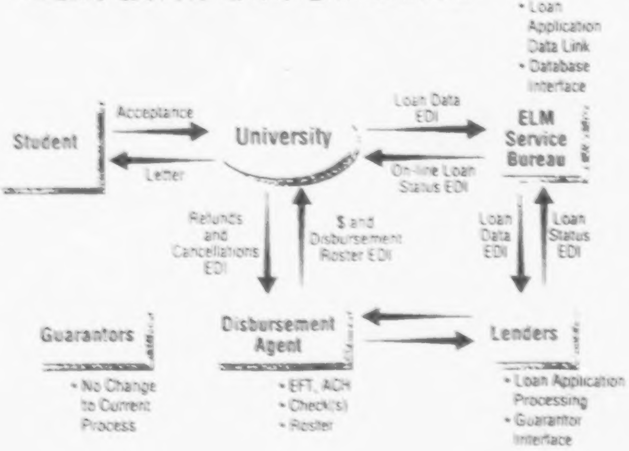
ELM Student Diskette

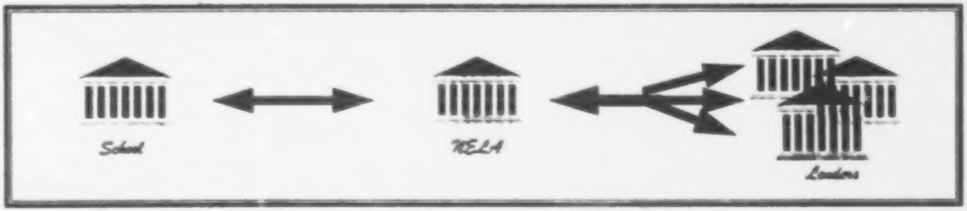
Data Collection
- FAFSA
- Stafford
- PLUS
- Scholarship
- State Grant Forms
- Institutional Financial Aid Forms

Processing (preliminary)
- EFC
- Budgets
- Need Analysis
- Award Package


Student/ Parent
FAFSA-Paper
Multiple Data Entry
ACT, CSS, PHEAA, DOE
SAR-Paper
Disks or EDI
FAFSA-EDI
University
Institutional Data-EDI
FAFSA Corrections EDI
ESAR-EDI
ELM Service Bureau
FAFSA-EDI
Central Processor Service

ELM Back-End Data Flow


• Loan Application Data Link
• Database Interface
Student
Acceptance
Letter
University
Loan Data EDI
On-line Loan Status EDI
ELM Service Bureau
Refunds and Cancellations EDI
$ and Disbursement Roster EDI
Loan Data EDI
Loan Status EDI
Guarantors
Disbursement Agent
Lenders
• No Change to Current Process
• EFT, ACH
• Check(s)
• Roster
• Loan Application Processing
• Guarantor Interface



ExpressWay

Application Processing Service

- School awards aid and certifies loan eligibility
- School electronically transmits FFELP application data to NELA
- NELA prints and mails FFELP loan applications to borrowers
- The borrower selects a lender and returns signed applications to NELA
- NELA processes the guaranty and electronically notifies the school and the lenders
- NELA tracks outstanding loan applications and sends follow-up letters to students

Centralized Disbursement Delivery Service

- NELA schedules disbursements in accordance with school's dates
- NELA receives and manages all funds from lenders in a centralized account
- NELA electronically transmits all data **and** funds to school

Fund Reconciliation / Adjustments

- School processes loan adjustments through NELA's Loan Adjustment Process
- School returns all funds to NELA for reconciliation and distribution to lenders

Northwest Education Loan Association

CSLR COALITION FOR STUDENT LOAN REFORM
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Testimony to the
ADVISORY COMMITTEE ON STUDENT FINANCIAL ASSISTANCE
April 11, 1995

by
Mark R. Cannon
Executive Director
Coalition for Student Loan Reform

I wish to thank Chairperson Lynn M. Fawthrop and the Members of the Advisory Committee on Student Financial Assistance as well as Executive Director Brian Fitzgerald for the opportunity to testify, on behalf of the Coalition for Student Loan Reform (CSLR), at this hearing focusing on reform of the Federal Family Education Loan Program (FFELP).

Background

Nine months ago, on July 7, 1994, CSLR published program improvement recommendations, entitled *Improving the Financial Aid Delivery System and the Federal Family Education Loan Program*. Our latest proposal was focused primarily on programmatic reforms to simplify and improve the systems, processes, forms and procedures used to deliver more than $23 billion in guaranteed loan assistance to approximately 6 million students annually.

The Advisory Committee's own study, issued a year earlier in July of 1993 entitled "*Student Loan Program Simplification: Final Report*," served as the basis for many of our recommendations. Later in my testimony, I will relate our ongoing implementation activities back to the recommendations in your study which you emphasized in your invitation to testify.

The Task Force that developed these recommendations was comprised of professionals from the financial aid and student lending communities, with one-third of the panel representing directly the view of the campus financial aid and business office. We also consulted with Advisory Committee staff, the National Association of Student Financial Aid Administrators (NASFAA) and the other major national higher education associations during our work-up.

When we released the report, it had garnered the support of five national education loan associations--the National Council of Higher Education Loan Programs (NCHELP), the Education Finance Council, the Consumer Bankers Association, the Student Loan Servicing Alliance and the Coalition of Higher Education Assistance Organizations (COHEAO). Also, 50 individual education loan organizations endorsed the recommendations.

Lack of Departmental Cooperation

While many of the Coalition's recommendations involve improvements that organizations can make on their own and collectively under current law, some of the key provisions require a reinterpretation of current regulations and the prior approval from the Department of Education of new forms, policies and procedures.

Sadly, in this area, there is little good news to report. Senate Education, Arts & Humanities Subcommittee Chairman Jim Jeffords asked a question point-blank to Governor Madeleine Kunin at the oversight hearing on direct lending on March 30 about changes that she thought might be needed to put the direct and guaranteed loan programs on a level playing field and assure a fair competition. While she answered that the guaranteed student loan community is "handling the competition extremely well," this sidesteps the issue that provisions are not equal under the two loan programs and the Department gives unfair advantage to FDLP in the way it administers the two programs.

This is an injustice to the more than 70 percent of schools and their students who, according to the General Accounting Office, will continue to be served by FFELP this upcoming academic year and the 30-40 million FFELP borrowers currently in repayment.

Several standardization initiatives and other reforms the guaranteed student loan community have proposed to the Department of Education are backlogged and the Department has been generally unresponsive and uncooperative in resolving open issues, even when we have used approved channels such as the Ad-Hoc Standardization Committee to negotiate many of the fine points and build community consensus before official submission to the Department.

It may be too easy to dismiss this complaint, given the vested interest in the guaranteed student loan program with which Departmental officials will be quick to charge my organization. To state the case credibly, I wish to document for you CSLR's own nine-month old history in dealing with the Department on FFELP reform.

What ensued between the summer of 1994 and now could charitably be described as foot dragging--months of Departmental delay, indecision and unresponsiveness that have effectively stonewalled any chance the Department and the guaranteed student loan community once had to build certain of these program enhancements into the loan delivery process for the 1995-96 academic year.

1. Beginning early last summer (timed so as not to interfere with the negotiated rulemaking on direct lending which was winding down by then), we consulted informally with Departmental staff about our soon-to-be-published recommendations. We sought and received agreement that the Department would hold FFELP Summit meetings much like they had been doing with FDLP. [Exhibit 1]

2. Upon publication of our report, we immediately opened a dialogue with the Department in a letter dated July 15, 1994. In this letter, we identified seven specific recommendations in our report that require the Department's concurrence and clarification of regulations and administrative policies. We confirmed the Department's pledge to hold regular monthly "summit" meetings to discuss FFELP issues and our

desire to assign a team of experts to work with staff within the Department that could be appointed to move these program improvements forward expeditiously. [Exhibit 2]

3. On August 5, we received a two-paragraph response from the Department to our July 15 letter, holding out the hope that the FFELP Summits would be the forum to move these reforms forward. [Exhibit 3]

4. The first of these Summits was finally convened on October 18. [Exhibit 4] Attended by more than 30 representatives of lenders, guarantors, secondary markets and servicers and their respective associations as well as representatives of the broader financial aid and higher education community, we were anxious to finally have some dialogue on the issues raised in the July 15 letter. Instead, of discussing our letter, the meeting with Senior Advisor Leo Kornfeld began with the reading of a complaint letter from a student borrower and, on this clearly unrepresentative sample of anecdotal evidence, we were treated to insult and haranguing about the complexities of the current loan program. Problem exaggeration, rather than problem resolution, was clearly the Department's agenda.

5. Meanwhile, CSLR submitted formal comments to the Department in response to a *Federal Register* Notice of Proposed Rulemaking on the Federal Direct Student Loan Program (FDLP) for Year 2 (October 3 letter) and FFELP-FDLP Parity Regulations (November 7 letter). CSLR's July 15 letter was an attachment to both submissions and so was the call for the Department to initiate an immediate review of regulatory provisions to be consistent with congressional intent that the two programs be subject to "parallel terms, conditions, benefits and amounts." [Exhibit 5]

6. The second Summit meeting on November 29 was more successful. At our urging, we focused in on two proposals, with the particularly urgency of one issue making it our highest priority: Use of the FAFSA as the loan application for FFELP. CSLR took

away homework assignments which it dutifully completed weeks in advance of the next FFELP Summit meeting on February 3. [Exhibit 6]

7. The third and fourth Summit meetings in February and a special sub-group meeting on February 17 were as disappointing as the first two Summits in terms of dashing any hope that the Department would approach them in the spirit they were intended...to work with us in a concerted way to press ahead on important FFELP reforms.

8. At the February 23 Summit, we stressed repeatedly the urgency of bringing closure to the FAFSA data access question and the pending new common application and/or promissory note. We asked for the same kind of quick response and cooperation that typified the decisionmaking under FDLP. A follow-up letter the guaranteed student loan community had promised was sent on February 28. [Exhibit 7] A second follow-up letter was sent late last month at our initiation as our further attempt to keep the process moving in the right direction. [Exhibit 8] On some points, the Department has not, and shows no willingness, to move beyond "problem identification." The Department even saw fit to unilaterally cancel our March summit meeting.

I have gone through this painstaking chronological review to point out an injustice that is being carried out many times over. Let me quickly point to a few proposed simplification initiatives backlogged at the Department:

- **Use of the FAFSA as the Loan Application.** The Department's approval we are searching for on behalf of a simplified process for schools and students takes two forms: One is a new common application and/or promissory note submitted by the Ad Hoc Standardization Committee and originally drafted by NCHELP that would make full use of data available electronically from the FAFSA to complete aspects of the loan application and/or promissory note for the student. Second is the need to make operational a process outlined in a two-year old Dear Colleague for assuring that any guarantor designated by the institution (and at the borrower's request) have access to students' FAFSA data electronically. Please note, consistent with the Advisory Committee's view, our proposal does not expand the FAFSA. Instead, we require that some additional borrower information (such as references) be collected on the promissory note (some of which can be preprinted).

The Department's objections to the draft common application and/or promissory note included insisting on the continued use of two of three borrower "check off" boxes to enable a student to accept or decline such options as deferring their loan while in-school (a benefit a subsidized Stafford borrower would be crazy to decline...though some unfortunately do because they don't understand the question.) The Ad Hoc Standardization Committee, in its work on the form, had agreed to relegate these questions to the borrower certification section which, admittedly, does not get read by most students. But, there is typically one right answer for a student who understands the question. For some who don't understand the question or check neither yes or no, the delays that result from having to contact the student for clarification are more agonizing than what the issue merits. Interestingly, too, removing the "check-offs" was good enough when the Department reached that decision in developing the Direct Loan Promissory Note. Why the double standard?

The Ad-Hoc Standardization Committee has received two written replies from the Department of Education, the last one--indicating this is their 'final word' on the subject--just arrived. Their final word concedes little and, needless to say, time has essentially passed us by for being able to use this improved process for students who will soon be receiving award letters from their institutions for the upcoming Fall enrollment and completing loan applications.

- **Expansion of the Quality Assurance Program** (QAP) to provide added relief from certain regulatory burdens for high performance schools. **The reauthorization of the Higher Education Act (under Section 487A) authorized the Secretary to expand both regulatory and statutory exemptions, on an experimental basis, for the QAP program.**

This was another priority recommendation in our reform proposal and our July 15 letter to the Department. We recommended 14 exemptions; the Department asked us to pare this down to our top six. Taking our cues from the financial aid community, we did. On February 3, the Department gave verbal assent to three. But, no official action has been taken on a single one as yet. Three out of 7,000+ plus regulations is really starting out small, but many would welcome any progress in this area.

- **Common Loan Consolidation Note.** This was submitted by the Ad-Hoc Standardization Committee on March 22, 1994. Like many of the forms NCHELP and the guaranteed student loan community have developed for the student loan program, this one has been adapted by the Department and is in use for the Direct Loan Consolidation program now. Approval of the form for FFELP continues to be withheld. Preliminary word coming back is that the Department may require two separate applications to separately consolidate a student's subsidized and unsubsidized loans. This is burdensome and confusing for the student, and somewhat defeats the purpose of consolidating into one loan. The Department's direct loan servicer is working from one application and internally keeping two separate accounts for consolidated borrowers who have both subsidized and unsubsidized loans. The Standardization Committee has proposed the same process for FFELP but are being warned that the student may forfeit the subsidy in this event. This is another example of an unacceptable disparity between programs to the potential detriment of students.

- **Status of the 1992 Regulations.** Soon after Secretary Riley took office, he did the right thing in suspending the enforcement of 1992 regulations developed for the FFEL program which contained many errors and inconsistencies from trying to incorporate changes made to the Higher Education Act during the 1986 and 1992 reauthorization and a half-dozen other pieces of amending legislation enacted in the intervening period. But, two years later, these regulations (on which all subsequent regulatory packages have been based) have not been clarified and remain "effective but not enforced." This

> creates confusion, but also forestalls universal application of additional simplified provisions for students that were part of this comprehensive regulatory package.

The true point I want to make to this Committee can perhaps best be made if we turn the tables. Let's pretend, for the moment, that the situation is reversed. There exists a competition between the guaranteed student loan program and a new direct loan program. But this time, Congress in 1993 was not skeptical, but a forceful advocate for direct lending against unrelenting opposition from an Administration that campaigned on reforming the public-private partnership but maintaining, more or less, the present program structure. While, the compromise legislation called for a test of the direct loan concept, the Administration managed to negotiate final legislative language that left the Secretary broad discretion over its implementation (with no exacting requirements, for example, to negotiate rules with the community). Indeed, the legislation was peppered throughout with words like "maintaining a private sector role" and the like. Upon passage of the legislation, a united (not a divided and skeptical) school community worked cooperatively and came forward to the Department of Education with, not simply ideas, but clear proposals and drafts of forms and policies for implementing direct lending.

Now, do you think it is possible under these circumstances that the Department of Education--using its administrative discretion, the vagueness of the statute, loopholes in the law, legal fine points, its discretion in the allocation of budget and staff resources, and the "bully pulpit"--could have frustrated the intent of Congress and delayed the effective implementation of direct lending for several years while in the meantime it used some of the same discretion, vagueness, and loopholes available to it to move forward aggressively on its desired agenda of reform of the existing program?

I believe it could. Neither the real present-day situation nor this fictitious scenario, though, is proper for an agency of the federal government charged with the administration of all federal student financial aid programs.

The Administration and the Department of Education have made it clear in word, deed and in proposals it continues to advocate to the Congress that it favors 100 percent replacement of the guaranteed student loan program with direct lending. In its passion--including the Department used to refer to employees it had reassigned to work on direct lending as its "A Team" (imagine the not-so-subtle message that sends to staff bent on advancement)--the Department has lost its objectivity.

There is a "can do" approach to the Department's implementation of the direct loan program, which we do not begrudge them. The Department, however, should be the unbiased administrator seeking to improve the effectiveness of all programs serving students, especially one the size and scope of FFELP. Where is their "can do" approach when it comes to improving FFELP?

Lack of FFELP-FDLP Parity in Regulations Impacting Student Borrower Benefits.

Combined with the previous examples I have given, I wish to provide this Committee with a summary list of 23 key program differences between FFELP and FDLP regulations that impact student borrowers directly. In virtually all of these cases, the Department is offering improved terms, streamlined procedures and/or less paperwork and documentation burdens for students served under FDLP than under FFELP.

CSLR, NCHELP and others brought many of these disparate rules and regulations to the Department's attention in comments on draft conforming regulations the Department issued on October 7 in their attempt to make the regulations under FFELP conform with regulations negotiated for Year 2 of direct lending. This list of 23 program differences was prepared by members of our Implementation Task Force based on a review of all final published regulations and other Departmental guidance in effect for the two loan programs, including the final conforming regulations published on November 29.

I remind this Committee of a provision in the Higher Education Act, as Amended--Section 455(a)--which calls for "parallel terms, conditions, benefits and amounts" between the two loan programs. It should be clear what Congress' intent is here. Let the evaluation of the two loan programs be a comparison of service, effective use of technology and program cost efficiency, not artificial barriers raised to the offering of identical program benefits for students.

The guaranteed student loan community is working in a concerted way to improve the financial aid delivery and loan servicing processes. There is ample evidence in the statute, such as Section 432(l)(1) on standardization in the Higher Education Act Amendments of 1992 to tell us that this is what Congress wants. While we have not always been able to move beyond being competitors in the marketplace, in more recent years there has been considerable time and talent devoted to working collectively on reforms for the common benefit of everyone, most importantly students and schools. Our major obstacle today is that our fiercest competitor--a predator who wants the market all to itself--also happens to be our regulator. This is not an inconsequential obstacle. Indeed, how well could MCI compete if it was regulated by AT&T?

This dynamic is unavoidable. However, Congress has charged this Committee to "advise the Secretary and the Congress on the operation of the Federal Direct Student Loan Program and the Federal Family Education Loan Program" and ultimately to make "final recommendations on the advisability of proceeding to full direct lending." (H. Rpt. 103-213, p. 454)

This Committee can help assure that there is a fair evaluation, proper attention being paid to simplification of both loan programs and adherence to parallel terms, conditions, benefits and amounts for the equal benefit of all students. CSLR urges this Committee to investigate the issues discussed above and raised by other members on this panel that speak to an improper management bias that we believe is clearly in evidence at the Department.

Program Features

I wish to offer some comments on behalf of CSLR related to issues raised in your letter of invitation on remaining areas of FFELP reform identified by the Committee.

Single Source Borrowing

The CSLR reform proposal addressed this concern head-on in Part D of our report. All FFELP participants should work to ensure that students are served by only "one guarantor, one lender, one holder" throughout their schooling and by one servicer throughout their repayment. Until the National Student Loan Data System is fully operational (and information on a student's prior lender and guarantor can be automatically retrieved), an intermediate process is necessary.

This intermediate approach entails a guarantor searching its records for a previous guaranteed loan when a prior loan is indicated. When the lender is different on two applications, the guarantor contacts the student and the institution to effectuate a change to ensure the same lender/guarantor/holder combination on all loans. In cases involving transfer students or mergers of guaranteed loan program agencies and similar circumstances, the guarantors involved will assure a "split holder/guarantee" situation is averted.

As your letter of invitation presumes, a major benefit of this approach is that students can be assured a single payment and the lowest payment possible when the repayment period begins.

Standardized Terms and Conditions

My earlier testimony addressed the need to assure equality of terms and conditions between FFELP and FDLP. In terms of standardizing terms within FFELP, we need to herald the great progress already made through statutory change. The Supplemental Loan for Students has been replaced by the unsubsidized Stafford loan. Thus, students now apply for a Stafford loan and their need determines the level of subsidy.

A further reduction in the diversity of programs was achieved by converting all loans from the 8%/10%interest rate to a variable interest rate. Additionally, all new loans are now being made as variable interest rate loans.

The greatest potential source of confusion remaining for student borrowers is the variety of repayment options and how to compare the relative costs and benefits of each. Standardized formulas and disclosures can be most helpful in this regard, as well as the availability of one-on-one student loan debt management counseling. Along these lines, I am pleased to report that our Implementation Task Force is nearing completion of a nationwide formula for the Income Sensitive Repayment Plan (ISRP) for which new Department-approved rules go into effect on July 1.

Even though laboring under a ten-year FFELP repayment rule, this makes full use of special five-year forbearance rules and graduated repayment provisions established under ISRP to allow students to structure their payments so that payments will range from 4% to 15% of the borrowers monthly gross income, depending on the debt to income ratio. This approach also assures that at least interest is paid, thus avoiding negative amortization.

The Department has accurately characterized our position--and, more importantly, that of the financial aid administrators who we consulted who were most adamant on this subject--as favoring ISRP over the Income Contingent Repayment Plan (ICRP) developed for the direct loan program that can lead to the build up of substantial "capitalized interest" debt. We also find ISRP preferable because of its reliance on self-reported borrower income that spares the student, and the student's employer, from any involvement with the IRS to verify income data or to collect the loan. For the sake of simplicity and consistency, ISRP should have the maximum 25-year repayment option allowed under ICRP. Additionally, the provision under

FFELP prohibiting any graduated payment from being more than three times the amount of prior payments should be eliminated.

Indeed, what has disturbed me in the Department's promotion of ICRP is the little attention they are paying under direct lending to offering the borrower-friendlier option of a forbearance for those who are only in need of short-term relief from their repayment obligation.

Interestingly, the full effect of the increased single source borrowing and the introduction of income-sensitive repayment options is a potential lessening of the need for students to enter into a Loan Consolidation program. Many students no longer have to consolidate their loans to achieve a single payment and more flexible repayment terms are available, offering advantages over a 25-year loan consolidation. This is a trend worth celebrating, as loan consolidation should not be for everyone, notwithstanding the elimination of the minimum balance requirement. Use of this option needs very careful monitoring, especially as the Department moves aggressively forward with its Direct Loan Consolidation plans.

I appreciate this opportunity to testify and will be pleased to answer any questions you may have. Thank you.

Lack of FFELP-FDLP Parity in Regulations Impacting Student Borrower Benefits

The following is a summary listing of 23 key areas of difference between regulations in effect for the Federal Family Education Loan Program (FFELP) and the Federal Direct Loan Program (FDLP) impacting student borrowers directly. In virtually all of these cases, the Department is showing an improper management bias offering improved terms, streamlined procedures and/or less paperwork and documentation burdens for students served under FDLP than under FFELP. This is notwithstanding a provision on the Higher Education Act, as Amended--Section 455(a)--which calls for "parallel terms, conditions, benefits and amounts" between the two loan programs.

- **Application Process**

1. FDLP utilizes the FAFSA as the loan application; ED continues to require a FFELP loan application with redundant student data. EFT, deferment, and capitalization authorizations are currently required on the FFELP application but are merely disclosed in FDLP. ED has only agreed to permit the EFT authorization to be a part of the borrower certification for the next FFELP Common Application. Separate authorizations will continue to be required under FFELP for deferment and capitalization.

- **Deferments**

2. FDLP borrowers who have outstanding FFELP loans made prior to 7/1/93 are eligible for any of the pre- 7/23/92 FFELP deferments, as well as FFELP deferments for new borrowers on/after 7/1/93. For example, a FDLP borrower could receive a 5 year unemployment deferment (2 under "old borrower" and 3 under "new borrower").

3. FFELP deferments are borrower-based. For example, a borrower who uses the full 3 year unemployment deferment, returns to school, obtains new loans, and subsequently becomes unemployed cannot defer the new loans on the basis of unemployment. Conversely, prior deferment usage under FFELP is not transferred to FDLP. Therefore, the borrower who uses the maximum deferment periods under FFELP and subsequently obtains a Direct Loan would be able to obtain the full deferment period again, including deferment of any FFELP loans consolidated under FDLP.

4. Documentation - FFELP documentation requirements to establish deferment eligibility are extensive and onerous, especially in the case of seldom utilized deferment categories. FDSL has no documentation requirements.

5. Deferment Period - FFELP has a 6 month backdating limitation; FDLP has no limitation on backdating.

6. Default - Under FFELP, a defaulted borrower forfeits deferment entitlement. FDLP has no restriction on extending deferments to defaulted borrowers.

- **Forbearance**

7. FFELP requires a written agreement; FDLP does not. FDLP forbearance periods are for 1 year but may be renewed (with no limitation) at borrower request; FFELP has 1 year limitations and requires borrower contact every 3 months. Renewals under the FFELP would require a new form. Under FFELP, forbearance while the lender is attempting to obtain documentation establishing death or disability is limited to 60 days; FDLP has no limitation. Under FFELP, forbearance is limited to principal: permits principal and interest to be forborne.

- **Repayment**

8. An income-contingent repayment plan (ICRP) is available only under FDLP. FFELP borrowers have the option of an income-sensitive repayment schedule, but terms are not comparable to ICRP.

9. First payment due date - FFELP Stafford loans must have a first due date within 45 days of entering repayment. FDLP state payment is generally due within 60 days.

10. FDLP permits negative amortization, which is prohibited under FFELP.

11. A very restrictive rule is imposed in FFELP graduated repayment plans which prohibits establishing any payment that is more than 3 times the amount of prior payments. This severely limits flexibility.

12. ED has stated that a FFELP borrower who combines two payments may not have the payment applied to future payments. In other words, if the payment amount is $50, and the borrower pays $100, the double payment may not be applied to cover the next two months installments but rather would only be applied to the current payment due. A payment would again be due the following month. FDLP permits advancement of the due date.

- **Consolidation**

13. The interest rate under FDLP is variable; FFELP interest rate is the weighted average of loans rounded up to the nearest percentage point. This could help the FFELP borrower in some interest rate environments and hurt during other periods.

14. FFELP borrowers cannot consolidate FDLP under FFELP.

15. Under FFELP, loans with different interest subsidy benefits must be consolidated together, resulting in forfeiting interest benefits on subsidized loans. FDLP consolidates them separately, thus retaining interest benefits on subsidized loans.

16. FFELP borrowers must be in their grace period or in repayment in order to consolidate. FDLP permits consolidation while in school.

17. FFELP borrowers must forfeit the in-school and grace status upon consolidation. FDLP Consolidation retains the in-school and grace period.

18. FFELP repayment length is based upon debt: FDLP repayment length is based upon the repayment plan selected.

19. FFELP defaulted borrowers must make three payments to be eligible for consolidation. under FDLP, no payments are necessary if borrower selects ICR.

- **Participation**

20. 100% FDLP schools are considered non-participating in FFELP. This implies that, upon withdrawal from FDLP, an institution would have to reapply to the Department for FFELP participation. During negotiated rulemaking, we were assured that an institution's withdrawal from FDLP would not require re-application to FFELP. However, the Secretary has notified agencies the 100% FDLP schools are not eligible for FFELP.

- **Disbursement**

21. FDLP loans may be disbursed in a single disbursement if more than half of the loan period has expired; this is prohibited under FFELP. FFELP disclosures must be provided to the student at or prior to disbursement; FDLP disclosures are provided after disbursement. FFELP lenders are not provided the authority to credit guarantee fees for disbursements returned by the school more than 120 days after disbursement; FDLP directs that all such fees be returned.

- **Counseling Requirements**

22. FDLP permits schools to adopt alternative counseling methods with performance measures for effectiveness.

- **Aggregate limits**

23. Under FFELP, if an undergraduate student does not borrow the full undergraduate loan aggregate amount, obtains loans for graduate study and subsequently returns to undergraduate study, the student may continue to borrow up to the undergraduate maximum. Department staff announced at the recent NCHELP Default Management Conference that this is not permissible in FDLP, and ED will issue a Dear Colleague letter rescinding this benefit to FFELP borrowers.

TESTIMONY TO THE ADVISORY COMMITTEE ON STUDENT FINANCIAL ASSISTANCE

APRIL 11, 1995

Good morning, my name is Carl Dalstrom and I am Senior Vice President for Guarantor Operations at USA Services. Thank you for inviting me to tell you about improvements that have been made to the FFELP. USA Services is an affiliate of USA GROUP, headquartered in suburban Indianapolis, Indiana. It processes applications for guarantee and performs other activities under the Federal Family Education Loan Program on behalf of twelve guarantors, including USA Funds. We are what is known in the industry as a "guarantor servicer."

USA Services' mission is to provide the highest quality, cost-effective, guarantee processing services and products to our guarantor customers for the benefit of the students, schools, and lenders that depend upon them. In order for that mission to be a reality, we must constantly improve and update our systems, services, and products, so that the guarantors can meet the changing needs of their customers.

We are proud of our past pioneering efforts that have already put many students and institutions ahead of the game with electronic loan applications, services that save schools time and money, and state-of-the-art customer assistance. Even so, direct lending has been a wake-up call for us, and we have responded by significantly improving the way we do business to give financial aid administrators ***what they've told us they need***: more campus control of the student loan process without increased cost, work and liability. Financial aid administrators also want to minimize complexities that are associated with the intermediated, multiple player environment of the FFELP.

In response to their expressed desires, USA Services and others began intensifying dialogue with financial aid administrators. These talks have helped clarify for guarantors and their servicers how best to improve the FFELP. In the past 18 months, guarantors and their servicers have translated suggestion into action. At USA Services, we didn't just apply small changes here and there. We overhauled our student loan delivery system from top to bottom to give financial aid administrators more control, and more flexibility to obtain the services that best fit their specific needs, with a focus on simplification.

In order to provide more control to the financial aid administrator, USA Services has already implemented significant improvements including:

- ***Providing significantly faster turnaround on all loan transactions.*** The time it takes to process most transactions at USA Services has been cut in half or better. For example, we can now disburse an FFELP loan in less than 48 hours from the time the application is received. We can, through a service called "Express Loan," approve a loan for disbursement on the same day when rapid turnaround is needed. When a status change must be made quickly, schools can call a toll free number and have many of those changes made immediately. This has been accomplished despite the biggest surge in loan volume in the nation's history.

- ***Giving financial aid administrators easier and more timely access to information about their borrowers.*** For example, we provide an on-line linkage to USA Services' computer system so that the financial aid administrator can easily and quickly answer students' questions about the status of their loans.

- ***Making our services more accessible.*** We have expanded our staff and extended available hours of our customer assistance personnel.

- ***Simplifying for financial aid administrators the process of making changes to student loans, once they are guaranteed or disbursed.*** Last year, we expedited the processing of many of these changes. This year we will implement improvements that will make the process less cumbersome, and next year we plan to give financial aid administrators direct control of this process by providing the ability to make these changes without our intervention.

- ***Reducing the workload of financial aid staffs.*** Last year, we introduced a process called "Full Circuit", which allows financial aid administrators to rely on USA Services to secure completed promissory notes from students and forward them to lenders, freeing schools from having to handle a paper student loan application or promissory note.

- ***Providing ways for financial aid officers to integrate FFELP processing with the rest of the work they do.*** For example, we are building interfaces between our school-based loan processing software, and software on the campus used to process other types of financial aid.

In sum, we believe we have found several significant ways to give financial aid offices more control over the process without increasing their workload, cost or liability. Eliminating the disadvantages associated with multiple players is quite frankly more difficult because it requires industry-wide cooperation and solutions. In the past 18 months, the industry has come together in ways that many thought would never happen. It has overcome proprietary interests to develop common forms and data formats, policy and procedure manuals, and consistent responses to servicing questions. We are accomplishing all of these improvements for one reason—to simplify the process for the school and the borrower. In addition to these efforts, industry participants have come together to form the Coalition for Student Loan Reform, which has proposed several regulatory reforms that would simplify the delivery and servicing processes for schools and students. NCHELP has similarly developed a list of reforms that could ease the application and loan delivery process. Further, a group of lenders in the program have formed a group called Educational Loan Management or ELM, to develop a streamlined approach to applying for financial aid, including the FFELP. All of these efforts are worth your further consideration.

I am primarily here today to describe for you the most recent development—a development that offers solid evidence that the industry is forging partnerships to eliminate the barriers associated with multiple players. It is called the "FFELP CommonLine Network". At the urging of the financial aid community, the idea behind CommonLine was developed by USA GROUP and Sallie Mae in January of this year. Already embraced by the National Council of Higher Education Loan Programs (NCHELP), it appears that CommonLine will soon be offered by all the guarantors in the country. As a result, CommonLine has generated a great deal of excitement among financial aid administrators across the country.

To understand the significance of CommonLine, one must first consider the situation that exists today. Schools typically deal with multiple lenders and guarantors, and therefore multiple destinations where they must send loan applications, and from which they receive information about those applications. It is usually not practical for these schools to build multiple and varied electronic interfaces. Therefore, a school that wishes to process loans electronically will typically pick one guarantor, lender, or servicer to transmit loan applications in this way. All other loans are handled manually, providing both the school and the student with a less effective and certainly slower method of having those loan applications processed.

CommonLine provides for a standard electronic student loan delivery system which will greatly simplify loan processing for schools by providing them a single method to process FFELP loan applications and gain electronic access to any guarantor, lender or servicer.

CommonLine is analogous to banking's Automated Teller Machine (ATM) networks, which allow you to transact business with your choice of hundreds of banks, using one machine and one process. By taking advantage of common file formats developed and finalized in the last few weeks by NCHELP, schools will be able to tap into a single network using their existing software product (with minor modifications) to exchange application and guarantee information with any participating guarantor or lender. Schools simply transmit the application data to the lender or guarantor of their choosing using CompuServe mailboxes, and they get the response they need delivered into their electronic mailboxes.

The advantages to the schools and students are obvious. CommonLine provides schools an inexpensive way for them to process FFELP applications essentially in the same way for all of their students, for any participating lender or guarantor the students choose. Schools pay only for their CompuServe subscription and minimal data transmission charges; use of the CommonLine Network is otherwise free. Further, it allows schools and students to continue to reap the benefits of choice without the hassle. Schools can select the lenders or guarantors that provide the highest quality services for their students, and advise those students accordingly. It also allows students to choose lenders that best serve their needs. The schools will be able to accommodate these choices more effectively because the complexity associated with communicating with multiple parties will be gone.

Providing you an example may be the best way to describe how CommonLine works:

- With CommonLine, schools will be able to use software packages such as WhizKid, which is USA Services' loan application entry and transmission software on a PC, to create all loan applications for their students and electronically transmit those loan applications, in a common format, to the CompuServe mailboxes owned by any and all participating lenders, guarantors, or servicers.
- The participating guarantors, lenders, and servicers will pick up these data from their mailboxes and perform their usual loan processing functions, after which they will send information about those applications (e.g., dollar amount guaranteed), in a common format, to the school's mailbox in CompuServe.
- The financial aid administrator will use WhizKid to pick up that application status information from the school's CompuServe mailbox and process all such data the same, regardless of the source.

The most significant change to emphasize here is that, for the first time in WhizKid's history, it can be used to process loan applications for any guarantor, even if that guarantor has no contractual relationship with USA Services, and even though that guarantor or guarantor servicer is a competitor of USA Services, or of one of its guarantor customers.

Other guarantors throughout the country plan to similarly modify their school-based software to support CommonLine, and allow it to be used to process loans for any guarantor and lender. A simple, open, standard method means better, faster service for schools and students.

We expect that CommonLine will be operational for the 1995 lending season. For example, WhizKid will be modified to communicate in this way in less than 30 days from now.

We are convinced that CommonLine will provide a major breakthrough in the industry's efforts to improve the FFELP delivery process for schools and students. We are also convinced that CommonLine is the foundation for the industry to bring many more exciting improvements to the financial aid community in coming years. Our role in a changing student-aid environment is to keep options open for schools and keep access open for students. CommonLine does just that, and we are committed to making it work.

Thank You. I will be happy to answer any questions you may have.

Repaying Federal Education Loans

How Much Will It Cost?

A borrower's total payments and interest charges will depend on several factors: the amount of debt, the interest rate charged on the loans, the length of the payback period, and the method of repayment. The following examples have been prepared to show consumers how much they could expect to pay in interest under five different repayment strategies.

	Standard Repayment	**Extended Repayment/ Loan Consolidation**
Jeff borrows $8,000 to finance his business degree. After graduation, he signs on as a management trainee at a supermarket. His starting salary is $23,000.	*Monthly Payment* $97 *Repayment Period* 10 years *Total Payments* $11,647 *Total Interest* $3,647	*Monthly Payment* $87 *Repayment Period* 12 years *Total Payments* $12,470 *Total Interest* $4,470
Anthony borrows $17,125 to finance his degree in elementary education. After graduation, he lands a teaching job at a rural school, earning $20,000 a year.	*Monthly Payment* $208 *Repayment Period* 10 years *Total Payments* $24,932 *Total Interest* $7,807	*Monthly Payment* $164 *Repayment Period* 15 years *Total Payments* $29,459 *Total Interest* $12,334
Rita borrows $55,000 to finance her undergraduate and law degrees at prestigious private universities. After graduation, she goes to work as a public defender, earning $25,000 a year.	*Monthly Payment* $667 *Repayment Period* 10 years *Total Payments* $80,078 *Total Interest* $25,078	*Monthly Payment* $425 *Repayment Period* 25 years *Total Payments* $127,350 *Total Interest* $72,350
Mr. and Mrs. Brown borrow $10,000 to help send their child to nursing school. Their combined income is $60,000.	*Monthly Payment* $121 *Repayment Period* 10 years *Total Payments* $14,580 *Total Interest* $4,580	*Monthly Payment* $96 *Repayment Period* 15 years *Total Payments* $17,203 *Total Interest* $7,203

Note: In each case, the annual interest rate is held constant at 8 percent over the life of the loan. The calculations for income-sensitive and income contingent repayment assume that the borrowers' incomes increase by 4 percent each year.

* Monthly installment amounts are based on FFELP graduated repayment rules. For larger loan amounts, payments are based on the payment schedules for consolidated loans.

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Graduated Repayment*	Income-Sensitive Repayment[†]	Income Contingent Repayment[‡]
Monthly Payment Initial: $93 Final: $131 *Repayment Period* 10 years *Total Payments* $12,461 *Total Interest* $4,461	*Monthly Payment* Initial: $77 Final: $88 *Repayment Period* 11 years, 7 months *Total Payments* $12,386 *Total Interest* $4,386	*Monthly Payment* Initial: $87 Final: $87 *Repayment Period* 12 years *Total Payments* $12,470 *Total Interest* $4,470
Monthly Payment Initial: $127 Final: $269 *Repayment Period* 15 years *Total Payments* $32,274 *Total Interest* $15,149	*Monthly Payment* Initial: $114 Final: $208 *Repayment Period* 15 years *Total Payments* $31,782 *Total Interest* $14,657	*Monthly Payment* Initial: $120 Final: $186 *Repayment Period* 17 years, 5 months *Total Payments* $33,592 *Total Interest* $16,467
Monthly Payment Initial: $394 Final: $671 *Repayment Period* 25 years *Total Payments* $140,294 *Total Interest* $86,294	*Monthly Payment* Initial: $357 Final: $404 *Repayment Period* 30 years *Total Payments* $148,390 *Total Interest* $94,390	*Monthly Payment* Initial: $294 Final: $641 *Repayment Period* 25 years *Total Payments* $143,843 *Total Interest* $97,277 *Unpaid Balance* $8,734 *Estimated Tax Liability* $2,445 *Total Borrower Cost* $89,722
Monthly Payment Initial: $87 Final: $164 *Repayment Period* 10 years *Total Payments* $15,577 *Total Interest* $5,577	*Monthly Payment* Initial: $167 Final: $203 *Repayment Period* 5 years, 9 months *Total Payments* $12,467 *Total Interest* $2,467	PLUS loans are ineligible for the ICRP

[†] Borrowers begin making payments that are equal to 4 percent of their incomes or the accruing monthly interest, whichever is higher. Borrowers are allowed to make interest-only payments only during the first five years of their loans. After the fifth year, the amount of the monthly payment is fixed for the remainder of the repayment period; the installment amount equals (1) 4 percent of the borrower's monthly income at the beginning of the sixth year or (2) the amount required to repay the loan within the authorized repayment period.

[‡] In each example, the borrower elects to limit the monthly payment to the amount required to repay the loan in equal installments over 12 years. Any tax liability is based on a 28 percent marginal rate.

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ADDENDUM TO STATEMENT BY CARL DALSTROM

The ICRP and Other Repayment Options

Now, I'd like to talk about the new income contingent repayment plan. Also known as the "pay as you can" plan, the ICRP bases monthly payments on borrowers' incomes. The goal of the ICRP is a worthy one. Borrowers in financial distress should be able to reduce their monthly payments to affordable amounts. But the ICRP's current structure poses myriad dangers to borrowers and taxpayers.

The ICRP's Dangers to Borrowers:

1. The ICRP is expensive because it lowers monthly payments in the early years of the loan and permits negative amortization – that is, borrowers may make payments that are less than the accruing interest. In some cases, the borrower doesn't have to make any payment, even though the interest meter will keep ticking away. Once a year, unpaid interest will be added to the principal balance. The rules limit interest capitalization to 10 percent of the initial principal, but unpaid interest in excess of the amount that can be capitalized will be added to the overall loan balance. If **any** creditor tried to market **any** product in this manner, consumer rights advocates would – correctly – attack such a scheme.

2. The ICRP will entice students to borrow more than they can ever comfortably afford to repay, trapping them into 25 years of financially-indentured servitude. By calling the ICRP the "pay-as-you-can plan," the Department is telling borrowers that they can borrow all they want without regard to whether or not they will be able to repay the loan. Worse, parents may use the ICRP as a convenient reason **not** to save for their children's education.

3. By telling students that the ICRP makes college loans more affordable, the Department is signalling borrowers that the

ICRP will make their loans cheaper. Yet, low payments in the early years of the loan and the distinct possibility of negative amortization make the ICRP one of the most expensive ways to repay a student loan.

4. Under the ICRP, the government will forgive an unpaid loan balance after 25 years, but the unpaid balance will be taxed as ordinary income by the IRS, and the taxpayers will assume the burden of the unpaid loan.

5. Thanks to the ICRP's complex payment formula, most borrowers will have no way of knowing whether the loan servicer calculated the payment correctly, how long it will take to repay their loans, or how much they'll pay in interest.

The ICRP's Dangers to Taxpayers

1. The ICRP will encourage overborrowing, raising program costs.

2. Some borrowers may be able to legally avoid payment simply by shifting income to spouses or others.

3. By pushing students to the ICRP, unscrupulous school operators can, in the words of this committee, "mask the consequences of poor educational programs." These schools won't have to worry about posting high default rates since unpaid balances will be forgiven rather than declared in default, 25 years after the borrower begins repayment.

4. Taxpayers will have to absorb most of the losses incurred when loan balances are forgiven. When monthly payments are insufficient to cover the accruing interest, taxpayers will take another hit. The ICRP is a zero-sum game: If the borrower doesn't pay the interest or the principal, the taxpayer does. Moreover, the Department has the authority to put borrowers who are in default into the ICRP. This tactic could easily

backfire. Permitting low-income borrowers to make below-interest payments will simply increase their borrowing costs and postpone the inevitable.

Although the ICRP, under the current rules, offers an unattractive choice to most borrowers, the goal of providing income contingent repayment remains worthwhile. Now that lawmakers on Capitol Hill have begun to consider whether the ICRP should be made available to borrowers served by FFELP loans, policymakers have an opportunity to address concerns that the ICRP's terms are too costly and vulnerable to fraud and abuse. For example, the costs associated with negative amortization could be addressed by restricting the number of years in which borrowers would be allowed to make payments that are insufficient to cover the accruing interest on their loan balances. Such a limitation would not only reduce long-term interest expenses but would also make it less likely that borrowers would leave unpaid loan balances at the end of 25 years. FFELP industry participants may also want to consider ways to discourage overborrowing. This could be achieved by adjusting the payment formula or providing incentives to borrowers who repay their loans sooner rather than later (smaller loans can be repaid more quickly than bigger loans).

Other Repayment Options

The good news is that borrowers who need payment relief have other, less costly ways to reduce their monthly installments.

- Both the guaranteed and direct programs offer long-term, equal-installment plans, which allow borrowers to stretch their repayment period from the standard 10 years to periods ranging from 12 to 30 years, depending on their debt levels. Long-term repayment plans can reduce monthly payments by as much as 40 percent, while still providing for the borrower to repay the entire balance.

- Both the FFELP and FDLP offer graduated repayment options. These plans offer low initial payments, which are then increased at regular intervals. These plans often appeal to borrowers who may have low post-school earnings but are confident that their incomes will steadily increase.

- Guaranteed loans offer an income-sensitive repayment option. Like the ICRP, income-sensitive payments are based on the borrower's income. However, negative amortization is not permitted except during periods of deferment and forbearance. This provision lessens the likelihood that the borrower will experience the substantial negative amortization that is possible under the ICRP. Another advantage of income-sensitive repayment is that lenders can tailor their plans to meet the needs of their borrowers. The ICRP follows a one-size-must-fit-all approach.

- In addition, borrowers can take advantage of deferments and forbearances to obtain short-term or long-term payment relief.

  Deferments enable borrowers to suspend payments on their loans for specified periods; this is a logical step for borrowers with subsidized Stafford loans because the government pays the interest that accrues during the deferment period.

  Forbearances allow the lender to suspend or reduce the monthly payment, or extend the repayment period. Depending on the borrower's need, a FFELP lender can stretch out the repayment period as long as necessary. Forbearance is one of the most flexible tools available to lenders. It can be used to custom-tailor a repayment program to meet the needs of an individual borrower. Lenders or their loan servicers maintain close contact with borrowers who are in forbearance. For example, a suspended-payment forbearance is granted only in increments of several months; the lender reviews the terms of

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> the forbearance before granting an extension. This helps to ensure that the borrower does not remain too long in a period of negative amortization. The terms of the forbearance can be modified, according to the borrower's needs. In short, FFELP lenders and loan servicers can and do use forbearance to arrange loan workouts on a case-by-case basis.

Today, the customer service representatives at USA Services and our sister company, the Education Loan Servicing Center, Inc., or ELSC, may more aptly be described as repayment counselors. Our representatives can not only tell borrowers about their numerous repayment options but, with the help of special software, tell borrowers what their payments would be under each of the available plans. We can even estimate interest rate costs under each plan to help borrowers understand the full cost of each plan. By guiding borrowers through the repayment maze, we can help them make sound and informed financial decisions.

Repayment assistance is free to the borrower, who pays no fees to arrange new loan terms. When a borrower arranges a consolidation loan, there are no application fees or prepayment penalties. And, by the way, our customer service representatives are available via a toll-free hotline.

I would like to dispel the notion that lenders are not hurt when a borrower defaults. Nobody wins when a borrower defaults. Not the borrower, not the taxpayer, and certainly not the lender or loan servicer. I want to emphasize that lenders and loan servicers have substantial incentives to help borrowers work their way out of their payment problems. A delinquent or defaulted loan does not generate income. A defaulted loan represents, at a minimum, a 2 percent loss of the original principal, and the loss of future interest income. The due diligence required in handling delinquent or defaulted loans is costly.

That's why we invest substantial resources in default prevention. These resources include nearly 200 employees who contact delinquent borrowers and help them avoid default, often by arranging new repayment terms. Indeed, in fiscal 1994, we prevented defaults on 86 percent of delinquent loan dollars, thus averting well over $2 billion in potential losses to lenders and taxpayers.

The ICRP Isn't for Everybody

In mid-1993, Congress created the income contingent repayment plan (ICRP) as a key feature unique to Direct Lending. The plan is intended to ease the monthly payment burden for student-loan borrowers who have low incomes and large debt loads. However worthy the goal, the ICRP, as it is currently structured, presents a difficult choice for consumers: Lower monthly payments in the early years of the loan pose serious long-term consequences, including substantially higher interest costs and a potential tax liability. Critics are concerned about a lack of safeguards against overborrowing and the administration's aggressive plans for marketing the ICRP to borrowers. Widespread use of the ICRP could expose taxpayers to significant losses on loans that are "forgiven" after 25 years.

The ICRP, as it is currently structured, presents a difficult choice for consumers: Lower monthly payments in the early years of the loan pose serious long-term consequences, including substantially higher interest costs and a potential tax liability.

On December 1, the U.S. Department of Education issued its final rules for a repayment plan that would enable student borrowers who receive direct government loans to tie their monthly installments to their incomes. The primary goal of the ICRP, dubbed the "pay as you can" plan by the Clinton Administration, is to assure borrowers that they won't have to make payments that are more than the government determines they can afford, no matter how high their outstanding loan balances.

Bowing to widespread criticism of the initially proposed rules for the ICRP, the Department made several major modifications to its formula for calculating monthly payments and interest charges, including a lower limit on the capitalization of interest during periods of negative amortization (when payments are insufficient to cover even the accruing interest). Capitalization of interest can substantially increase borrowing costs, because borrowers must pay interest on interest. Some student and school groups argued that the proposed rules would significantly increase interest expenses for thousands of borrowers.

The Department's changes will reduce total, long-term interest expenses for some *but certainly not all* borrowers who elect to use the ICRP. Yet, even in cases where the changes will reduce total interest costs, borrowers are still likely to find themselves paying considerably more in interest than they would under other flexible payment options such as extended or graduated repayment plans.

By reducing the limit on capitalized interest, from the proposed limit of 50 percent of the initial loan principal to 10 percent, the Department has increased costs for taxpayers.

By reducing the limit on capitalized interest, from the proposed limit of 50 percent of the initial loan principal to 10 percent, the Department has increased costs for taxpayers. The government must sell debt securities to fund direct loans. The ICRP allows borrowers to make regular monthly payments that are not sufficient to cover the accruing interest. In such cases, Washington must borrow additional funds to cover interest payments to government bondholders. Under the 50-percent limit, the Department of Education estimated that the additional interest-rate subsidies during the first five years of the program, when the number of direct loan borrowers will still be relatively low, would total $471 million.* By slashing the cap to 10 percent, the Department created an even bigger interest rate subsidy.

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* "Direct Loan/FFEL Program Cost Update," Office of the Under Secretary, U.S. Department of Education, September 1994

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Critics had cited other drawbacks to the Department's initial design for the ICRP, claiming that the plan would help higher-income borrowers more than lower-income borrowers, encourage excessive borrowing, and, thanks to the highly complex payment rules, invite some individuals to avoid repayment by "gaming" the system. The Department did amend the payment formula to ease the repayment burden for low-income borrowers. However, the final rules increase the complexity of the payment calculations and do not adequately address the lack of safeguards against overborrowing, fraud, and abuse.

The final rules increase the complexity of the payment calculations and do not adequately address the lack of safeguards against overborrowing, fraud, and abuse.

Despite these concerns, the ICRP is expected to appeal to a large number of borrowers for two reasons. First, many graduates, especially those who do not realize the long-term interest costs, may jump at the chance to make extremely low monthly payments during the early years of the loan. Second, the Department of Education has announced plans to promote the ICRP, not only to direct loan customers, but also to students with guaranteed loans issued under the well-established Federal Family Education Loan Program (FFELP), including those who are already in active repayment.

How the ICRP Works

The goal of the ICRP legislation was to provide low monthly payments for borrowers with low incomes or very large debt burdens. Payments are determined by a complicated formula that takes into account the borrower's debt burden, gross income, discretionary income, marital status, and household size. The following summary of the ICRP's key features is based on the final regulations.

Payments are determined by a complicated formula that takes into account the borrower's debt burden, gross income, discretionary income, marital status, and household size.

- Unlike the equal-installment approach of traditional repayment plans, the ICRP uses a variable-payment structure. Each year, monthly installments are based on a stipulated percentage of the borrower's adjusted gross income (AGI) for the previous year. This percentage, which ranges from 4 to 15 percent, is determined by the initial loan balance. Installments can be reduced for borrowers with little discretionary income, which is calculated by subtracting the federal government's estimate for a poverty-level income for the borrower's household size from the borrower's AGI.
- Payments can be waived if less than $15. Under the proposed rules, the threshold for waiving payments was $25.
- To help low-income borrowers, the Department amended the formula to prevent monthly installments from exceeding 20 percent of discretionary income, dropping a proposed payment reduction of $7 for every nonspouse dependent.

The Department amended the formula to prevent monthly installments from exceeding 20 percent of discretionary income.

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If the monthly payments are insufficient to cover accrued interest, the unpaid portion is added annually to the principal.

- The ICRP allows loan balances to *grow* even for borrowers who make regular payments for years. If the monthly payments are insufficient to cover accrued interest, the unpaid portion is added annually to the principal. Although the principal balance—the amount that is subject to interest charges—is never allowed to exceed 110 percent of the initial principal, unpaid interest in excess of the cap continues to accrue and remains an obligation of the borrower. (For example, unpaid interest on a $1,000 loan can be capitalized until the principal balance reaches $1,100; any additional unpaid interest would be added to the total balance but not to the principal.) Consequently, borrowers with heavy debt burdens must pay down the accrued interest before any portion of a payment is applied to the principal.

- Borrowers can elect to cap their monthly payments at the amount that would be required to pay off the initial loan balance in equal installments over a 12-year period. (Following a period of negative amortization, the capped amount is recalculated to reflect the increase in the outstanding loan balance.) This option helps high-income borrowers with heavy debt loads.

- The monthly installment must be recalculated once a year to reflect any increase or decrease in the adjusted gross income reported on the borrower's federal tax return, as well as changes in the borrower's marital status and discretionary income. The calculations must also take into account adjustments in the federal government's estimates of threshold income levels for individuals and families living in poverty.

The government will cancel any unpaid balances for borrowers who are unable to repay their loans in full within 25 years, but "forgiven" loan balances will be taxed as ordinary income in the year in which the loans are forgiven.

- The government will cancel any unpaid balances for borrowers who are unable to repay their loans in full within 25 years, but "forgiven" loan balances will be taxed as ordinary income in the year in which the loans are forgiven. Based on current federal income tax rates and the amounts forgiven, borrowers could face tax bills, payable in the year after the loan is forgiven, equal to 15 percent, 28 percent, 31 percent, or even more of their outstanding loan balances. Failure to pay the tax bill would result in penalties assessed by the Internal Revenue Service (IRS). The Clinton Administration has expressed an interest in legislation that would eliminate the tax liability, but the acceptability and durability of this tax break is highly questionable.

Existing guaranteed loans were decreed eligible for direct loan consolidation to enable "virtually all FFEL borrowers" to repay their loans under the ICRP.

- At present, the ICRP is available not only to students who receive direct loans but also to FFELP-only borrowers who consolidate their guaranteed loans into direct loans. (Parents may not use the ICRP to repay PLUS loans.) Indeed, in proposing the consolidation rules, the Department of Education stated that existing guaranteed loans were decreed eligible for direct loan consolidation to enable "virtually all FFEL borrowers" to repay their loans under the ICRP. Thus, the Department is targeting borrowers who have been successfully repaying their loans under one of several repayment plans offered by the FFELP, including an income-sensitive plan and a graduated payment plan, among others. (In addition, effective July 1, 1995, borrowers who are attending Direct Lending schools may consolidate their FFELP loans under a direct loan while still in school.)

The Department says it will limit ICRP eligibility to FFELP borrowers who cannot obtain consolidation loans from private lenders, or who have requested income-sensitive repayment terms from their lenders and found the terms offered to be unacceptable. Officials, however, have not taken steps to implement such restrictions, and, to date, there is no evidence that the Department requires documentation from the borrowers proving that they had requested different repayment terms or any evidence that the lender was unable to comply with these requests.

Members of Congress have already expressed their dismay that the Department's direct-loan consolidation forms bury the borrower's certification of eligibility in "boilerplate" language, which many people are unlikely to understand or even read.

Members of Congress have already expressed their dismay that the Department's direct-loan consolidation forms bury the borrower's certification of eligibility in "boilerplate" language, which many people are unlikely to understand or even read. Legislation introduced in mid-January by Rep. William Goodling (R-PA) would restrict FFELP borrowers' access to the ICRP via consolidation to those who could not obtain a guaranteed loan or who demonstrate both financial need and a preference for income-contingent repayment.

- To use the ICRP, borrowers must authorize the IRS to divulge key information on their federal income tax returns to the Department of Education. Reliance on tax return data means that borrowers' payments will be based on their incomes during the previous year.

Concern about Safeguards

Critics contended that the ICRP lacked essential consumer and fiscal safeguards.

The Department's initial plan was roundly criticized by student groups, schools, and even lawmakers who have ardently championed the development of flexible repayment options. These critics contended that the ICRP lacked essential consumer and fiscal safeguards. Although the final regulations address these concerns to a limited degree, the ICRP remains an expensive option for most borrowers.

- The interest paid by low-income borrowers could easily amount to twice the interest they would owe under other plans.
- For borrowers who anticipate relatively low incomes in their immediate, post-school years, substantial increases in education debt produce only nominal increases in their initial monthly payments. Under the Department's formula, a student who expects to earn $20,000 a year can increase borrowing from $2,500 to $25,000 before doubling the initial monthly payment (from $72 to $147). At that point, the borrower's payment would not cover the interest (at the current rate), and the balance would increase. Thus, borrowers are

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encouraged to overborrow under the illusion that the additional debt results in little, if any, additional cost. Of course, the potential consequence to the borrower is 25 years of repayment without ever paying off the loan.

- The final rules, which set the maximum payback rate at 15 percent of adjusted gross income or 20 percent of discretionary income (whichever is lower), could exacerbate the problem of overborrowing by individuals who focus strictly on the monthly payment amount. Under the new formula, a married borrower earning just $15,000 a year who elects to use the 12-year payment cap would be asked to make a monthly payment of just $54 to repay a $5,000 loan. The borrower would start making installments of $73 a month for a $10,000 loan, $85 for a $15,000 loan, and only $86 a month for any amount greater than $15,200. Even the payment for a $100,000 debt would be just $86! Critics fear the ICRP payment formula will entice students who have the weakest financial resources and prospects to borrow more than they could ever afford to repay.

The final rules, which set the maximum payback rate at 15 percent of adjusted gross income or 20 percent of discretionary income (whichever is lower), could exacerbate the problem of overborrowing

  Another danger is that schools participating in Direct Lending will find it easier to raise tuition. Students will have to borrow more, but the schools can point out that, under the ICRP, bigger debts won't mean bigger monthly installments. Moreover, the ICRP could provide an open invitation to scam schools, which won't have to worry about whether their students can repay their loans because the Department does not plan to calculate default rates for Direct Lending schools.

- The plan's complex payment calculations will be difficult to administer and could easily invite fraud and abuse. Informed observers charge that borrowers can "game" the system, for example, by shifting income to spouses or others.

- Under the ICRP, loans that remain unpaid after 25 years are canceled rather than declared in default. The IRS, however, will treat forgiven loan balances as taxable income to the borrower. This provision will be particularly painful for borrowers with modest incomes, who won't have the resources to pay a sudden tax bill. But taxes, if collected, will offset only part of borrowers' unpaid balances. The rest of the red ink will be absorbed by taxpayers.

As noted earlier in the *Network*, the new chairs of the House and Senate education panels have expressed serious doubts about the Department's rules and marketing plans for income contingent repayment. Congress may conduct hearings to examine the consumer issues raised by the ICRP.

The ICRP's Cost to Borrowers and Taxpayers

Compared to other payment plans, the ICRP will substantially increase interest expenses for both borrowers and taxpayers.

Compared to other payment plans, the ICRP will substantially increase interest expenses for both borrowers and taxpayers. Lower installments mean longer payback periods and greater total interest expenses over the life of the loan. The ceiling on interest capitalization and the loan forgiveness provisions will shift a substantial part of the repayment burden from borrowers to taxpayers.

Limiting interest capitalization to 10 percent of the initial principal will provide little, if any, financial relief for most borrowers. Consider the following examples:

- Gina borrows $7,500 to finance her undergraduate degree in French literature. Unable to find a job as a translator, she goes to work at a photocopy store, where she earns $15,000 a year. If she elects to use the ICRP's capped-payment option, her income grows by 4 percent a year, and the annual interest rate holds steady at 8 percent, she would pay off the loan in about 13½ years. Her monthly installments would start at $65 and eventually increase to $81. In all, she would make payments totalling $12,474, including $4,974 in interest. Gina could save more than $1,500 in interest charges by using the standard repayment plan, which would require a fixed monthly installment of $91 a month (7.3 percent of her initial income) and retire the loan within 10 years.

- Derrick borrows $55,000 to fund his undergraduate degree and law degree at prestigious private universities. Eager to serve his community, he takes a $25,000-a-year job as a public defender. To lower his monthly payments, Derrick decides to repay his loans under the ICRP. Assuming that Derrick chooses the 12-year payment cap, his income increases 4 percent a year, and the interest rate remains constant at 8 percent, he can expect to pay $97,277 in interest over the next 25 years. Because he will leave an unpaid balance of $8,734, he also can expect a tax bill for approximately $2,500, raising his total cost to nearly $100,000. Taxpayers must absorb more than $6,200 in unpaid principal. Because negative amortization during the first eight years of repayment will increase the outstanding principal balance by about 8 percent, it makes no difference whether the limit on capitalized interest is set at 10 percent or 50 percent.

Who would benefit from the 10 percent limit on the amount of interest that is subject to compounding? Borrowers with very low incomes and/or very high debt burdens. For instance, under the 50-percent limit, someone with $80,000 in debts and an initial salary of $30,000 could expect to make payments totalling $187,407, including $183,703 in interest, and leave an unpaid balance of $76,297. Assuming the borrower is able to pay more than $21,000 in federal income taxes (based on a 28-percent marginal rate) on the forgiven loan, taxpayers would be left with a tab

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of about $55,000. Under the 10-percent cap, the borrower would make payments totalling $187,407, pay $168,989 in interest, leave an unpaid balance of $61,582, and owe more than $17,000 in taxes. Over the life of the loan, however, taxpayers would have to absorb substantial interest expenses after the borrower reaches the 10-percent limit on capitalized interest, pushing taxpayers' total cost well above $55,000. In effect, the ceiling on interest capitalization creates a zero-sum game: If the borrower doesn't pay the interest, the taxpayer does.

The ceiling on interest capitalization creates a zero-sum game: If the borrower doesn't pay the interest, the taxpayer does.

Who Needs the ICRP?

Lawmakers and others have expressed concern that promotion of income contingent repayment by the Department of Education will prompt borrowers who would be better served by one of the other available repayment options to choose the ICRP and, consequently, unnecessarily increase their interest costs. Because the average total loan balance for students after they leave school is under $10,000, most borrowers should be able to manage their payments under the standard, 10-year, equal-installment plan.

Lawmakers and others have expressed concern that promotion of income contingent repayment by the Department of Education will prompt borrowers who would be better served by one of the other available repayment options to choose the ICRP and, consequently, unnecessarily increase their interest costs.

Borrowers who are shouldering bigger debt loads can choose among a number of options designed to ease their monthly payment burdens. Direct-loan customers may extend the 10-year payback period and reduce the installment amount via the extended repayment or graduated repayment plan. Borrowers who receive guaranteed loans under the FFELP also have several flexible repayment options available to them, including consolidation, graduated repayment, and an income-sensitive repayment plan. These methods provide payment flexibility and do not encourage excessive negative amortization. In addition, borrowers who are experiencing short-term financial difficulties can obtain temporary relief by requesting a period of deferment or forbearance.

Switching to the ICRP may benefit borrowers who would otherwise default on their loans, because the short-term and long-term repercussions of default are severe. The ICRP may appeal to individuals who incur hefty education debts but have strong expectations of substantial earnings growth (for example, medical school graduates who earn modest salaries while completing their hospital residency requirements), but these borrowers should evaluate their other repayment options—long-term, equal-installment plans or graduated repayment may provide the needed flexibility at a lower interest cost. Borrowers who have modest or poor income expectations should be cautioned to fully explore the ramifications of choosing the ICRP to repay a substantial amount of education loans. These borrowers are likely to see their loans immediately sink into negative amortization and remain there for years.

To ensure that only the borrowers who truly need or want the ICRP choose this repayment option, schools and the Department of Education must take extra care in counseling students about their repayment options and obligations.

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Borrowers—especially those with little experience in managing credit—cannot make an informed decision unless they fully understand the long-term costs and potential tax consequences associated with the ICRP.

The ICRP may offer borrowers the lowest monthly payments, but it also carries the greatest risk that education debts will truly become a mortgage on their future buying and borrowing power.

Conclusion

Flexible repayment plans are intended to ease the initial payment burden for students after they leave school, but each carries a price. Reduced payments in the early years will boost total interest costs and erode discretionary income over the long haul. The ICRP may offer borrowers the lowest monthly payments, but it also carries the greatest risk that education debts will truly become a mortgage on their future buying and borrowing power and may infringe on their ability to help their children finance a college education.

Advisory Committee Testimony-- April 11, 1995

Good morning. My name is Ruth Lammert-Reeves. I am the Assistant Dean for Financial Aid at Georgetown University Law Center. Many thanks to the Advisory Committee for the opportunity to come and talk today about issues of concern to students who use the FFELP program to meet their college/university costs. With some 60% of all college students continuing to rely on FFELP for the 1995-96 year, I appreciate that FFELP is receiving some much-needed attention, and hope this interest carries over to other venues as well.

My frame of reference for the FFEL Program is the experiences of professional students--law students specifically, who borrow up to $18,500 annually between the Stafford and unsubsidized Stafford loans to help cover the cost of law school. Georgetown Law Center has an enrollment of about 2,400 students--2,000 students who pursue J.D. degrees and an additional 400 students earning master degrees in various areas of legal specialties. Approximately 85-90% of our students borrow loans while in law school. Last fall our entering students came from 48 states, plus the Virgin Islands and Puerto Rico.

The average graduate in the class of 1995 owes $43,000 in federal loans from law school and an average of $4,100 for undergraduate education. Those debts result in approximately $630 per month under a standard 10 year repayment plan. This year, we disbursed $27.5 million in federal Stafford and unsubsidized Stafford loans for our students.

Our students' great reliance on the FFEL Program has given us many opportunities to note the numerous strengths and weaknesses of the Program and suggest how it might be modified to better serve our students.

My presentation today will focus on two major areas. These two broad areas are: **1) improvement of the delivery of loan funds to students and 2) the ease of loan repayment for borrowers.**

Delivery of Funds to Students

The delivery of loan funds to students includes: ease of application, including the process of applying--can we eliminate the application process per se, and the clarity of the application/p-note to the borrower.

There are numerous advantages to students if we are able to integrate the application for federal loans into the application process for other Title IV aid. This integration process has taken a circuitous route. It began with the implementation of a common loan application -a major step in simplifying the application process for FFELP borrowers. I had hopes for greater improvements when I read late last fall about an effort to streamline the FFELP application process by allowing data from the FAFSA to serve as the basis for a student's loan. I was intrigued with this idea and followed up on what progress was being made to effect this change for the 1995-96 year.

Unfortunately, from what I can tell, a process that started out fairly optimistically in December got derailed somewhere along the way, and as I understand it, the Department of Education's Office of General Counsel has not approved the revised non-application/p-note yet, (this is my name for it-) so our students will be completing applications for their federal loans separate from the FAFSA for this upcoming year.

The delay in the approval of the "non-application" is disappointing. But it is also troubling, because it appears that items identified as problems on the suggested FFELP form are perfectly acceptable on the Federal Direct Loan Program promissory note. The draft FFELP non-application borrows several concepts from the FDL Program--but I understand that these same concepts are what has delayed approval of the revised FFELP non-application. These items include:

1) the proposed FFELP non-application eliminates asking a separate question for whether or not the student wishes to borrow an unsubsidized Stafford. There is not a separate question on the FDLP promissory note.

2) the proposed form does not ask the student if s/he wishes to defer interest on the unsubsidized loan during periods of deferment, nor does the FDLP promissory note.

3) the proposed form does not ask if the student approves receipt of the funds via electronic funds transfer, nor does the FDLP promissory note.

I believe the absence in FFELP of the streamlining permitted the Federal Direct Program is a real disservice to our students. All of the items mentioned here are issues that have delayed approval of the revised FFELP non-application. There may be others, but these are the ones I am focusing on because of their direct affect on students. It is not clear to me why there should be a different interpretation on the merits of the arguments between the two programs.

A regulation which I believes harms students is the rule requiring two equal disbursements within the loan period, regardless of how short or long the loan period is. For a student who is finishing his/her degree at the end of a summer term, requiring two disbursements during a 6 or 8 week term is absurd. The disbursement process becomes even more cumbersome if the student is visiting another school. In this instance, the student usually has to have another source-parent, friend or credit card, from which they can borrow to tide them over until the second disbursement arrives, usually late, because the check is made payable to the student and home school, which has to obtain the student's signature, deposit the funds to the student's account at the home school, and then issue a refund. If the process is streamlined by using eft, there are often still delays in the student receiving the funds. Even requiring two disbursements during a regular 15 week semester is unnecessary. If disbursing funds twice during one semester is so beneficial, why don't we require two disbursements per term for everyone, regardless of whether the loan is for an academic year or just one term. Or why not disburse loan proceeds monthly or weekly???

REPAYMENT ISSUES

The second area I would like to address is the repayment side. The word I would like to leave you with is **consistency**, or I should say, lack of it. Here, Congress bears much of the responsibility for what I think are some of the major problems. Although there are other important issues where the Department of Education could provide solutions.

The area of total confusion for students is the difference in loan names and terms for seemingly the same loan, and sometimes for the same borrower. If I borrowed before Wednesday, but after Monday, my interest rate for my federal loan is one rate. But if I borrowed Tuesday at 11:59 p.m. and it happened to be a lunar eclipse, I have a different rate, but only during years that end in an even number. I would like to suggest an item for inclusion on the proposed legislative amnesty day that the House Republicans have suggested. My proposal would be to use the same basis for determining the interest charged, and the same deferment, forbearance and grace periods for each type of federal student loan. If you have a Stafford Loan, the interest is always going to be based on the following criteria.....If you have a Stafford and return to school at least half-time in a degree or certificate program, you may always defer the loan, etc. Would this be so hard? Would it cost a lot of money? I think the defaults arising from the confusion over repayment have to more than equal the cost of standardizing the terms. It has to be easier than the computer programs that are probably still being developed to cope with the interest rate changes that will occur this July. In any case, I invite any ED official that is here, or anyone else who thinks they know from interest rates, deferments and grace periods to come give an exit interview to graduating students and face the confused looks on people's faces when you try to explain loan program terms. An old SLS is pretty much just like an unsubsidized Stafford except that the interest rate basis is different and the grace period is shorter...except if you ask for the grace to be extended before the first payment is due your lender has to give you a deferral until your Stafford goes into repayment...and so on.

People who work in student aid everyday cannot keep the information straight. I'm willing to wager two percentage points of a typical school's default rate that confusion over terms pushes the default rate up. A national "reconcile the terms of federal student loans" amnesty day would go a long way to helping borrowers keep things straight when they enter repayment.

For borrowers who transfer schools or enter graduate/professional school, deferral of prior loans has been made far simpler by the implementation of a universal deferment form. In my experience, this was an area that was long overdue for reform. We had lenders who would not accept the form for their program if had been photocopied to a different color of paper.

Now, we need a standardization of forbearance forms as well. I understand a draft of a forbearance form is still being digested at the Department of Education--no predictions on if or when it will see the light of day. Adoption of a common consolidation form is also being delayed. A potentially major issue that students are probably not aware of yet is the difference in interpretation the Department has made for consolidation options between the FDLP and the FFEL Programs. ED has interpreted the law very favorably for FDLP borrowers and the exact opposite way for FFELP borrowers. Under FDLP, the interest subsidy continues under consolidation for eligible loans. As currently structured, the interest subsidy does not continue under consolidation for FFELP loans that would otherwise be eligible for deferral. I find this a troubling inequity between the two programs.

There is also a lack of comparability in other aspects of repayment--most significantly in not offering income contingent repayment in FFEL. I know there are bills in Congress which would authorize parallel income contingent repayment options in FFELP, but until those bills become law, income contingency is not available to a borrower unless the borrower transfers his/her loans into an Individual Education Account (IEA). When this occurs, at least as I presently understand it, the student cannot transfer his/her loans back to a traditional loan consolidation program. You might wonder why a borrower would want the option of using loan consolidation offered by organizations other than the government.

The answer is simple: repayment incentives. Sallie Mae and others provide incentives such as lower interest charges if the borrower uses automatic withdrawal from his/her bank account. If the borrower maintains an on-time payment record for 4 years, the interest rate is reduced by an additional 2% for the remainder of the borrowers repayment. Right now, to my knowledge, none of these innovations exist or are in the planning stages in I.E.A. Borrowers need to be able to make choices.

I think it is fair to say that the development and implementation of the FDL Program is much further along than a typical new program might otherwise be because of the existence of the FFEL Program. The reverse is also true. FFELP gave the shapers of the FDL Program a measuring stick to aid in the development of FDLP. Innovations in FDL had the impact of providing remarkable clarity to FFELP players. In my opinion, agreement within the FFELP industry on issues such as a common loan application would not have occurred without pressure exerted by the looming presence of the FDL Program. I applaud the fact that this situation has been allowed to occur, because I think it has benefitted our students, and I hope the motivation for innovation and improvements continues.

Thanks again to the Advisory Committee for the opportunity to express my views on how to improve the FFEL Program.

Jean S. Frohlicher
President
National Council of Higher Education Loan Programs

Madame Chairman and Members of the Advisory Committee

Thank you for asking me to appear today, representing the National Council of Higher Education Loan Programs (NCHELP). NCHELP's voting membership is comprised of State-designated guaranty agencies and State-based secondary markets charged with the administration of the Federal Family Education Loan Program (FFELP). Associate members include other participants on the "provider" side of student loans -- lenders, servicers, collectors, and institutions of postsecondary education.

We appreciate the Advisory Committee's continued attention to the important issue of FFELP reform and the many constructive suggestions the Committee has made for the Program's improvement. Unfortunately, it does not appear that the Department shares the Committee's commitment to FFELP reform. Virtually unlimited resources have been invested by the Department in implementing the Federal Direct Student Loan Program (FDSLP), while attention to FFELP issues has languished and the number of personnel involved in developing regulations and policies for the program has been eroded.

Even prior to the enactment of the Omnibus Budget Reconciliation Act of 1993, with its creation of the FDSLP as competition for FFELP, participants in the latter have consistently sought to improve their services to students and institutions. The FFELP community is confident that it administers the better program, and would welcome the opportunity to prove it if we believed we had a "level playing field" on which to do so.

We recognize that all terms and conditions of the two loan programs cannot, because of statutory differences, be identical. For example, FFELP loans can be consolidated into FDSLP, but the reverse is not true. Similarly the Department of Education is authorized to provide income-contingent repayment options, with forgiveness of any unpaid balance after 25 years; FFELP participants do not have the same authority.

Unfortunately, however, it appears that ED is undertaking an orchestrated campaign to make the two programs as different as possible, by refusing to approve community efforts to streamline FFELP offerings to students and their institutions. Appended to my testimony as Attachment A is a letter to Secretary Riley from the major organizations representing the FFELP community expressing their concern at the Department's unwillingness to allow improvements to the FFELP delivery process.

Other panelists will go into more detail concerning their efforts to gain ED approval of the ELM process and the use of the FAFSA as an application document for the FFEL Program. In neither case have ED personnel appeared willing to cooperate with the community in finding solutions to perceived problems. Rather the Department has interpreted the statute as narrowly as possible, a significant contrast to their liberal interpretations of the law regarding FDSLP.

One area in which substantial progress has been made is in the standardization of forms and procedures for FFELP participants. Since the enactment of the Higher Education Amendments of 1992, with its provisions mandating standardization, NCHELP and its committees have been actively involved in furthering that goal. The creation of the Ad Hoc Committee on Standardization, chaired by Dallas Martin of NASFAA, has provided the forum for the entire higher education community, including institutions of higher education, FFELP participants, students, and legal services representatives, to meet and discuss issues in standardization. The Committee then makes a community-wide recommendation to the Department for its approval.

To date, the Ad Hoc Committee has recommended to the Department, and negotiated on, the following standardized forms:

- Common subsidized/unsubsidized Stafford Application
- Common PLUS Application
- Common Consolidation forms
- Common deferment forms, including a revised hardship deferment form to reflect subsequent statutory changes
- Common cancellation form for permanent and total disability
- Common garnishment forms and procedures
- Common claim and preclaim forms and procedures
- Common procedures for guarantor review of lender skip-tracing

While the process has worked reasonably efficiently, it cannot be said to be working to the community's satisfaction. Departmental staff are extremely prescriptive in their approval of standard forms, dictating not only content and layout but also margin width and type face. And, in too many instances, the FFEL community has been denied approval of forms that have been acceptable for use in the Direct Lending program, thereby putting FFEL borrowers at a disadvantage.

Appended to my testimony as Attachment B is the Department's response to the Ad Hoc Committee concerning its most recent proposal for the common Stafford application form. As you will note, ED requires the FFEL form to continue to have check-boxes for the borrower to indicate his interest in deferment of his loan obligation while he is in in-school status and in allowing the lender to capitalize the accrued interest during that period – items the FDSLP form includes as notice items to the borrower. In addition, ED is requiring the continuation of a lender section on the FFEL form, even though this section is used only for the lender's internal record-keeping and provides no information or substantive value either to the borrower or to the school. Finally, ED refuses to allow a guaranty agency to assign a borrower's application to his most recent FFELP lender, in furtherance of the statute's "one lender, one holder" rule, raising questions whether such action (by a guarantor, NOT an institution) might give rise to inference of lender liability under the FTC holder rule. The letter states that "OGC firmly believes that the school is responsible for ensuring that the applicant completes the entire 'borrower section'...." This would appear to NCHELP to give unscrupulous institutions greater control over a borrower's choice of lenders than a mere assignment by a guaranty agency to a prior lender. It will surely result in processing delays if the section is inadvertently left blank.

ED has also cited statutory barriers to allowing FFELP consolidators to continue to extend benefits to subsidized Stafford borrowers on those loans included in a consolidated loan, as provided for in FDSLP. The Ad Hoc Committee has appealed to Secretary Riley to waive the perceived statutory prohibition, as FFELP consolidators would otherwise be severely disadvantaged in availing themselves of extended and/or income-sensitive repayment options.

Too often, the Department's goal appears to be standardization-for-standardization's-sake, rather than a focus on the legitimate needs of the borrower. In a parallel to their decisions on the common Stafford application, ED is considering requiring guaranty agencies to print the consolidation form, rather than allowing lenders to print the common form, as they now print their own forms. In addition, ED wants all discussion of repayment options on the form to be generic, with information about the lender's specific options contained only in wrap-around materials. Generic information does not help a borrower in deciding which option is best for him. Wrap-around materials can get lost, rendering the form useless to the borrower.

Perhaps the most successful industry improvement efforts have been those that the community undertook without seeking Departmental input or approval. The NCHELP CommonLine℠ Network, an outgrowth of a proposal initially made by USA GROUP and Sallie Mae, appears to be enthusiastically accepted by the guaranty agency community, with almost all agencies planning to be in electronic communication with their institutions during this school year. Through the efforts of the NCHELP Program Operations Committee, a common data set has been developed through which any guaranty agency can guarantee a loan upon receiving information electronically from the institution. Attachment C details agencies' plans to participate in CommonLine℠.

To provide operational-level guidance to the FFELP community on implementation of Departmental regulations and "Dear Colleague" Letters, organizations representing the community have established the Program Administration Review Council (PARc). This Council, through its Facilitation Committee, is developing common recommendations on operational issues where seeking Departmental guidance would be an invitation to micro-management. Among its current projects is the Repayment Options Workgroup, which seeks to systematize and standardize borrower repayment options in the FFEL Program.

Finally, regional groups of guaranty agencies, led by the New England guarantors, are developing common policy manuals, so that institutions need only deal with a single set of policies for the major guarantors. The Rocky Mountain guarantors are similarly developing a manual, and USA GROUP has offered its policy manual for consideration and/or adoption as a basic document. These activities are in direct response to legitimate institutional concerns about interpretational differences among guaranty agencies, and provide a stepping stone to a national policy manual in the not-too-distant future.

In short, the FFEL community is willing and eager to follow the Advisory Committee's lead in simplifying and standardizing the FFEL Program for students and schools. Our major impediment appears to be the Department of Education, which is either inattentive to FFELP community concerns or intentionally obstructive to our efforts at reform. What we are facing is a situation where FFELP is being regulated by an entity -- the Department of Education -- which views it as a competitor. Who can say how much progress MCI might have made if AT & T had been in charge of regulating its growth? We look forward to working with the Advisory Committee in assuring that much needed reforms become a reality.

Attachment A

April 10, 1995

The Honorable Richard Riley
Secretary
U.S. Department of Education
600 Independence Avenue, S.W.
Room 6263
Washington, D.C. 20202

Dear Mr. Secretary:

We are deeply disturbed at the extent to which the Department of Education has used its regulatory and oversight authority to preclude effective delivery of program improvements to student and parent borrowers in the FFEL program. Cited below are numerous instances which call into question the intention of the Department to regulate the Student Loan programs in the public interest and in the manner intended by Congress. The consistent opposition of the Department to efforts by the FFEL community to improve loan delivery to students effectively precludes establishing the same terms and conditions necessary for a valid comparison of the two programs and does a great disservice to the vast majority of student loan borrowers who participate in the FFEL program.

We would appreciate your reviewing the following issues and indicating what action the Department might to take to provide the same terms and conditions for borrowers in the FDSL and FFEL programs. If current law and\or regulations restrict your ability to provide students and schools equal benefits and opportunities in both programs, we would appreciate your suggestions of any changes necessary to insure that FFEL participants, including students, schools, and providers are given the full support of the Department of Education in the delivery of the FFEL program.

1. **1995-96 Common Application** – The Department's continued delays in approving a new common application form for the FFEL programs means that processing delays and confusion identified by the configuration of the current application will continue into the upcoming academic year. The changes to the form were all approved by the Ad Hoc Committee on Standardization in November 1994, and a final draft was delivered to the Department in early December. In all instances, the Direct Loan Application which has been approved by the Department takes the same approach as that proposed by the FFELP community. However, Departmental staff have refused to allow similar improvements in the FFELP form.

2. **FFELP Consolidation Form** – ED staff stated that the Office of General Counsel had ruled that statutory language (which had been drafted by the Department as part of the OBRA process in 1993) precluded the FFELP community from continuing to provide subsidies on subsidized Stafford loans included in a consolidated loan, as allowed in FDSLP consolidation. This ruling, which would significantly disadvantage FFELP borrowers wishing to consolidate their indebtedness with their FFELP lender, creates a disparity between the two consolidation programs. The Ad Hoc Committee on Standardization has appealed to you to waive the statutory barrier, and the community awaits your decision on this highly important matter.

3. **Use of FAFSA as an application document for FFEL** – In July 1994 the Coalition for Student Loan Reform transmitted seven FFELP reform proposals to the Department which required your assistance in implementing. Two of the proposals were the use of the FAFSA as the FFELP application and the ability for guaranty agencies to obtain FAFSA data electronically. These same issues were on three FFELP Summit agendas with no resolution being realized. Subsequently a meeting with ED personnel at the technical level to resolve the issues raised by the community's proposal to allow the guaranty agency designated by the institution (at the borrower's request) to access FAFSA data electronically has not resulted in a final resolution and a response from the Department is still outstanding. Such access would significantly simplify the application process for students and schools, and would convert what is currently a costly manual process into a quicker electronic one. It would also allow the FFEL application process to mirror the Direct Lending process at the school level.

4. **Threats of sanctions for institutions participating in the ELM process** – ELM, a FFEL community-developed application process for student financial aid, would allow a prospective student to fill out application forms on his/her own PC and forward them, through ELM for a determination of aid (including FFEL) eligibility. Department personnel have stated that only the FAFSA can be used for such determination, and only through the mechanism of EDExpress or the paper FAFSA printed by the Department even though the ELM software "may be better." Departmental policymakers have been unwilling to seek mutually-agreeable solutions to the impediments they feel exist. We believe ELM to be an extremely promising breakthrough in simplifying a process for the individual student by using technology not previously available.

5. **Confusion surrounding the status of the 1992 FFEL regulations** – You suspended the enforcement of the 1992 regulations for the FFEL Program soon after taking office, since you agreed with the community that they were flawed and internally inconsistent. Departmental policymakers insist that the regulations are "effective but not enforced" and that the FFEL community should be making "good faith efforts" to comply with them. These statements are interpreted differently among ED regions, and audit exceptions are, in some cases, being taken because of noncompliance. Three years later, the community has not yet been informed when, if ever, the regulations (on which all subsequent regulatory packages have been based) will be corrected and enforced.

6. **Development of a new title IV student aid delivery system** – A major undertaking is in progress in the Department to develop a new, streamlined, delivery system for title IV HEA student financial aid. There is no FFELP representation in this effort, apparently reflective of the Department's underlying assumption that the Direct Loan Program will be the only Federal loan program by the time the new delivery system is in place – an assumption not supported by existing law or Congressional intent.

7. **Arbitrary determinations concerning use of guaranty agency reserve funds** – Departmental staff assigned to monitor guaranty agencies have issued arbitrary and capricious determinations concerning the acceptable use of agency reserve funds to support program improvements and innovations. Letters have been sent to all guaranty agency heads by the Department demanding prior notification of any capital expenditures of 5% or more of an agency's reserves which, for a small agency could mean the purchase of a modern computer system or the substantial upgrading of computer software. Implicit in such notice is the Department's ability to disapprove any such expenditure it wishes, under the general assertion that it is protecting the Federal fiscal interest. Similarly, although ED had approved guarantor participation in the National Student Loan Clearinghouse, which significantly simplifies the burden of reporting student status which institutions had previously borne, guaranty agency oversight personnel have now, without citing any reasons, informed a guarantor that such participation will not be deemed an appropriate use of agency reserves once the National Student Loan Data System is functional. Since ED takes the position that all of an agency's funds are Federal funds, this ruling would effectively preclude any continued guarantor

participation in a Clearinghouse which has been enthusiastically accepted by the school community.

8. **Refusal of the Secretary to conform FFEL and FDSL Regulations** – By narrowly circumscribing the "parity" regulations despite the understanding of those participating in negotiated rulemaking, the Department made no real attempt to conform the two programs. Specifically we note the absence of conforming amendments in the following areas:

    Capitalization – Additional requirements for lenders under FFEL could have been modified in the rulemaking process.

    Repayment – Repayment options could have been simplified by enhancing graduated and income sensitive repayment schedules and extending administrative forbearance provisions.

    Deferments – Many administrative requirements for deferments were reduced or eliminated in the FDSL regulations. The same consideration was not given to participants in FFEL.

    Forbearance – In addition to the lack of administrative forbearance noted above, FDSL regulations eliminated several general forbearance provisions and documentation requirements (e.g. written forbearance agreement) specified under FFELP. Consideration of these simplification steps could just as easily been made available to FFELP borrowers.

    Loan Discharge – Numerous changes to the closed school/false certification discharge of loans made in FDSL (e.g. exceptional circumstances, requirement for execution of the promissory note) were not extended to FFEL program in the regulatory process.

    Prepayment – Options for prepayment were specifically and repeatedly discussed in negotiated rulemaking of the FDSL program with the assumption that these would be part of the FFEL/FDSL conforming regulations. They were not.

9. **Unsupported legal interpretation regarding IRS offsets for Income Contingent Repayment** – The contention that the Department may subrogate up to 10% of the defaulted loans which have an outstanding

IRS offset is a clear misreading of statute and the intent of Congress in testing an Income Contingent Repayment plan.

Taken individually, some of these Departmental positions may not appear significant. Taken together, they create a convincing pattern of Departmental negativism toward any FFELP improvement which might make the public/private partnership more competitive with Direct Lending, to the detriment of schools and students. ED strategy clearly appears to be micromanagement of FFELP, and keeping it as burdensome and unresponsive toward its clientele as possible, while simultaneously publicly extolling the improvements and responsiveness of Direct Lending. It is untenable for FFELP to continue to be regulated by personnel committed to proving the superiority of Direct Lending.

We are looking forward to receiving your response to the above issues as soon as possible.

Sincerely,

Jean S. Frohlicher
President
National Council of Higher
Education Loan Programs

Bill Hansen

William D. Hansen
Executive Director
Education Finance Council

Joe Belew

Joe Belew
President
Consumer Bankers Association

Mark R. Cannon

Mark R. Cannon
Executive Director
Coalition for Student Loan
Reform

cc: Madeline Kunin
Leo Kornfeld

Attachment 8

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF POSTSECONDARY EDUCATION

APR 7 1995

Dr. Dallas Martin
Chairman
Ad Hoc Standardization Committee
National Association of Student Financial
  Aid Administrators
1920 L St. N.W., Suite 200
Washington, DC 20036-5020

Dear Dr. Martin:

Per your request at the March 8, 1995 meeting of the Ad Hoc Standardization Committee (the Committee), the Department of Education (the Department) has reconsidered several determinations made regarding certain items contained in the draft common Federal Stafford application outlined in our March 7 letter. As a result of our further discussions and consultation with staff of the Department's Office of General Counsel (OGC), the Department requests that the following changes, in addition to those identified in the March 7 letter, be made in the application and supporting materials and a final draft of the common application materials for the Federal Stafford Loan (subsidized and unsubsidized) Program be submitted to the Department for final approval:

BORROWER SECTION

1. Lender Identification Information.

Several committee members were unclear about OGC's view that the proposed language to the instructions for the lender choice data element constitutes a "business arrangement" that would result in liability for the lender under the Federal Trade Commission's (FTC) Holder Rule. Therefore, the committee requested that OGC review its position and suggested that the instructions could be further clarified to specify that if the applicant leaves this field blank and the applicant has a prior FFELP loan(s), the guaranty agency, not the school, would complete the item using the applicant's most recent FFELP lender to process this new loan. OGC continues to believe that the relationship between the school and the agency would constitute a referral that would result in liability for the lender under the FTC holder rule. OGC firmly believes that the school is responsible for ensuring that the applicant completes the entire "borrower section" of the application form prior to sending it forward to either the lender or guarantor. This process ensures that it is clear that a third party did not choose a lender for the applicant, contrary to

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statutory intent. Therefore, please amend the instructions for data element #7 to advise the applicant that the loan is being made by a financial institution (i.e., bank, credit union, savings and loan association, etc) rather than the school or the guarantor and that the applicant's failure to complete this item may result in a delay in the processing of the application.

2. Loan Type Request.

The Department strongly believes that we have a responsibility to the consumer to provide sufficient information so that the applicant is aware of what he or she is applying to receive. We are not satisfied that there are other systems currently in place in the loan processing system that effectively and efficiently preserve a borrower's choice to decline all or a portion of the loan without delaying the timely delivery of loan proceeds to the borrower. Therefore, please retain this data field on the application form, but revise it to read as follows, "I do not wish to receive an unsubsidized Federal Stafford Loan (see instructions): a. No. I do not want an unsubsidized Federal Stafford." Modify the instructions for Item #11 to read as follows, "Check this box if you do not wish to receive an unsubsidized Federal Stafford Loan. Refer to your Statement of Borrower's Rights and Responsibilities for information about the difference between a subsidized and an unsubsidized Stafford Loan. Note: If you leave this item blank, it will be assumed that you want to be considered for both a subsidized and an unsubsidized Stafford Loan."

3. In-School deferment request.

Several committee members had concerns about whether this data field is necessary at all since 34 CFR 682.210(c)(1)(i) provides that the borrower may provide the lender with a certified loan application as documentation of the borrower's eligibility for a student deferment. However, as was indicated in the March 8 meeting, the Department does not view the school's certification of borrower eligibility for a new loan as the deferment request required in §682.210(a)(4). Therefore, we continue to believe that a data element is needed to make the borrower aware that the borrower's loan(s) have entered a repayment status and the borrower needs to make a decision to either make regular monthly payments or request a postponement of repayment. Please revise data element #13 to read as follows, "I do not wish to postpone (defer) repayment of my Stafford and prior SLS loan(s) during the in-school and grace periods: a. No, I do not want a deferment." Modify the instructions for Item #13 to read as follows, "Check this box if you want to make payments on your loans that are in repayment status while you are in school. Note: If you leave this item blank, it will be assumed that you want a deferment, and you will not be required to make regular payments while in school."

4. Request for capitalization.

The Department strongly believes that we have a responsibility to clearly inform the borrower of the impact of the borrower's choice on the borrower's total debt. This data field and its accompanying instructions are of such importance to the borrower's overall indebtedness that we must require retention of data element #14. However, we will allow it to be changed to read as follows, "I am requesting that the lender not add the interest on my unsubsidized Stafford and prior (SLS) loan(s) which accrues during the in-school and deferment periods, to my loan principal (capitalization). a. No, I do want my interest capitalized. Note: If you leave this item blank, it will be assumed that you want your lender to capitalize your interest while you are in-school and during deferment periods, and you will not be required to make interest payments."

SCHOOL SECTION

5. Cost of Attendance (COA), Expected Family Contribution (EFC), and Estimated Financial Aid (EFA).

Several committee members believed that while the regulations are prescriptive about the information to be provided to the lender by the eligible school, a more reasonable reading of this requirement would provide for the school to retain the information in the school's records which could be made available to the lender upon request. However, OGC advises that given the specific language of section 428(a)(2)(A) and the program regulations, this approach is not supportable. OGC believes the Department must seek a statutory change and amend current program regulations to remove the provision under §682.206(c)(2) that requires a lender to review the data on the student's COA and EFA that is provided by the school before these data elements may be removed from the information that the school certifies to the lender making the loan.

LENDER SECTION

The Department continues to oppose the elimination of the "lender section" of the application form. OGC believes the lender is the responsible party in the making of a FFELP loan, regardless of the business arrangement between the lender and the guaranty agency. Under 34 CFR 682.206, a lender is required to perform certain loan making functions including determining the loan amount. Eliminating the lender's portion of the application form would be inconsistent with these regulatory requirements and would eliminate what should be a lender's role in ensuring that loan applications are properly completed and reflect legal requirements. It also confuses the borrower as to the maker of the loan and would leave lenders at risk for FTC holder rule liability as a result of a referral relationship with the school. Therefore, the entire "lender section" must be retained, although it may be identified as optional.

The Department wishes to thank the Ad Hoc Standardization Committee for its continuing work in the development of common FFELP application forms and standardized procedures. The Department views the determinations made on these items as its final decision. We believe that this information and that previously contained in the Department's March 7 letter will allow the Ad Hoc Committee to prepare the final common loan application materials for submission to the Department. Please contact me or Patricia Lyles of my staff if we can be of any further assistance to either the Committee or members of the NCHELP Program Operations Committee as they prepare the final version of these materials.

Sincerely,

Pamela A. Moran
Chief, Loans Branch
Policy Development Division
Policy, Training, and Analysis Service

cc: Ms. Nina Hold
NCHELP Program Operations Committee

Ms. Jean Frohlicher
Executive Director, NCHELP

Attachment C

NCHELP CommonLine™ Network Survey Results

Attached are the results of an NCHELP fax survey, conducted March 28 - April 5, 1995. The survey indicates that all guarantors are committed to implementing the FFELP CommonLine Network as part of their electronic guaranty process. In the immediate lending cycle for the 95-96 academic year, it appears that all but one, perhaps two, small guarantors will be able to receive and transmit data through the CommonLine Network at Levels I & II. Fully 80% of the guaranty agencies will be participating at Level III -- which means they will have modified school-based software based on the NCHELP CommonLine network electronic formats.

NCHELP estimates that for the 1996-97 lending cycle every guarantor will be participating in the CommonLine Network at Level III, which means that schools will no longer have to maintain separate software systems for different guaranty agencies and/or lenders. The benefits to schools in terms of simplicity and flexibility will mean greatly enhanced service to students, decreased financial aid office workloads and, potentially, substantial cost savings. While it is difficult to provide an accurate prediction of the total FFEL loan volume which will be processed using the CommonLine Network, there is every reason to believe that virtually all schools which generate loan applications electronically will have access to a single software system capable of guaranteeing FFEL loans for any borrower, regardless of which lender or guaranty agency is chosen by the borrower.

Agency	Participate?	Levels and Implementation Date
Northstar (MN)	Yes	Level III 5/95
North Carolina	Yes	Level III 7/95
Great Lakes (WI)	Yes	Level I 5/95 Level II/III 6/95
Maine	Yes	Level III 7/95
New Jersey	Yes	Level I 7/95 Level II Fall/95
NELA (WA & ID)	Yes	Level III 7/95
Virginia	Yes	Level III 7/95
ASA (MA, DC, etc.)	Yes	Level III 7/95
North Dakota	no	Unable in 95/96 will try for 96/97
Illinois	Yes	Level III 6-8/95
Kentucky	Yes	Level I & II 7/95 Level III 12/95
Arkansas	Yes	Level III 5/95
PHEAA (PA)	Yes	Level III 7/95
Indiana	Yes	Level III 5/95
Oklahoma	Yes	Level III 5/95
Oregon	Yes	Level III 5/95
Vermont	Yes	Level I fall/95 Level II & III 7/96
Louisiana	Yes	Level I & II 6/95
Alabama	Yes	Level I & II 7/95 Level III 12/95
Connecticut	Yes	Level I 5/95 Level II 6/95
California	Yes	Level I & II 6/95 Level III 10/95

Florida	Yes	Level I & II 7/95 Level III
New Mexico	Yes	under consideration for 95/96 yes for 96/97
EAC (South Dakota)	Yes	Level III 7/95
Iowa	Yes	Level III 7/95
Texas	Yes	Level I & II summer/95 Level III fall/95
Utah	Yes	Level III 7/95
Kansas	Yes	Level III 7/95
Montana	Yes	Level III 7/95
Alaska	Yes	Level III 7/95
Hawaii	Yes	Level III 7/95
Mississippi	Yes	Level III 7/95
Nevada	Yes	Level III 7/95
Wyoming	Yes	Level III 7/96
Colorado	Yes	Level III Summer/95
Rhode Island	Yes	Level III 7/95
Tennessee	Yes	Level I fall/95 Level II winter/95 Level III fall/96
Michigan	Yes	Level III fall/95
New York	Yes	Level I & II 5/95 Level III 8/95
Nebraska	Yes	Level III 8/95
South Carolina	Yes	levels I & II 9/95

The FFELP CommonLine℠ Network

The FFELP CommonLine Network is an industry-wide effort to provide a common basis for the electronic exchange of data and provide a simplified and standardized method for guaranteeing loans and exchanging data. The attached overview provides information and illustrations of how the process will work. The term CommonLine is "service marked" to ensure that it can only be used in reference to student loan processing and is not the property of any particular organization. The process it describes, "The FFELP CommonLine Network", allows participants the flexibility to retain existing school based software systems while becoming a part of a common data exchange network.

The cooperative development of standard electronic file formats was the first step in a larger effort to provide a common means of data exchange. Completion of the "flat-file" formats was the result of the combined efforts and input of many student loan organizations, including both members and non-members of the Program Operations Committee. They are intended as standard transitional formats as the industry moves towards the use of ANSI EDI standards and have been distributed to all guaranty agencies as well as lenders, secondary markets, servicers, software developers and other interested parties.

NCHELP will soon be releasing a guide on the use of CompuServe to link schools, guarantors, lenders and other organizations in the FFELP CommonLine Network using the common formats. This approach will allow schools to transmit and receive certification and guarantee data in common formats which will in turn allow application processing for multiple guarantors through a single school based software package.

By providing a greatly simplified loan guaranty process with the flexibility now offered by most school-based software, schools will be relieved of much of the current complexity and will be provided a cost-effective alternative to direct government lending. NCHELP encourages you to begin changes needed to implement use of the common formats and encourages your participation in the FFELP CommonLine Network data exchange through CompuServe.

If you have any questions or would like additional information about the FFELP CommonLine Network, please contact Greg Gollihur at NCHELP (202) 547-1571, Tom Wenmam, NCHELP Program Operations Committee (802) 654-3728, Jon Kroehler of USA Group at (317) 595-7122 or Laurie Campbell of Sallie Mae at (202) 298-2684.

NCHELP
FFELP CommonLine^{SM} Network

Implementation Manual
for Guarantors, Lenders, and Servicers

April 7, 1995

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I. FFELP CommonLine℠ Network

The FFELP CommonLine℠ Network is an industry-wide effort to provide a common basis for the electronic exchange of data and will provide a simplified and standardized method for guaranteeing loans and exchanging data. The term CommonLine is "service marked" to ensure that it can only be used in reference to student loan processing and is not the property of any particular organization. The process it describes, "The FFELP CommonLine Network", allows participants the flexibility to retain existing school based software systems while becoming a part of a common data exchange network.

Development of the standard electronic file formats was the first step in a larger effort to provide a common means of data exchange. This guide explains the use of CompuServe to link schools, guarantors, lenders, and other organizations in the FFELP CommonLine Network using the common formats. This approach will allow schools to transmit and receive certification and guarantee data in common formats which will in turn allow application processing for multiple guarantors through a single school based software package.

By providing a greatly simplified loan guaranty process with the flexibility now offered by most school-based software, schools will be relieved of much of the current complexity and will be provided a cost-effective alternative to direct government lending. The National Council of Higher Education Loan Programs (NCHELP) encourages you to begin changes needed to implement use of the common formats and encourages your participation in the FFELP CommonLine Network data exchange through CompuServe.

How CommonLine works (a synopsis):

The Financial Aid Administrator uses school-based software to transmit loan applications to the CompuServe® mailboxes of participating lenders, guarantors, and/or servicers.

Participants pick up the loan application and certification data from their CompuServe mailboxes, and continue with their normal loan processing functions.

When processing is complete, guarantors, lenders, and/or servicers send information (e.g., guarantee, rejection) about the application(s) they have processed to the school's CompuServe mailbox.

The Financial Aid Administrator uses school-based software to retrieve the application response information.

How application processing organizations can participate:

OPTION #1:

Establish a CompuServe mailbox.
Modify your system to receive data from CompuServe.
Enhance your system to process application and certification data in the CommonLine Application file format.

OPTION #2:

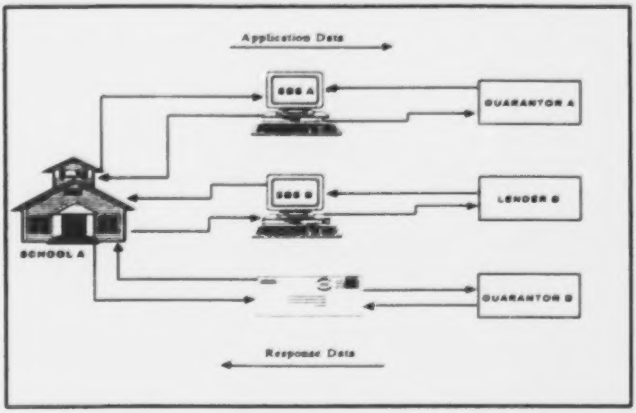
In addition to the above, modify your system to create and transmit response information (i.e., guarantee and rejection statuses) to the school's CompuServe mailbox, using the CommonLine Response File format.

OPTION #3:

In addition to the above, if you support your own school-based transmission software, you will add the capabilities to your software which are described in this document.

II. Overview of CommonLine

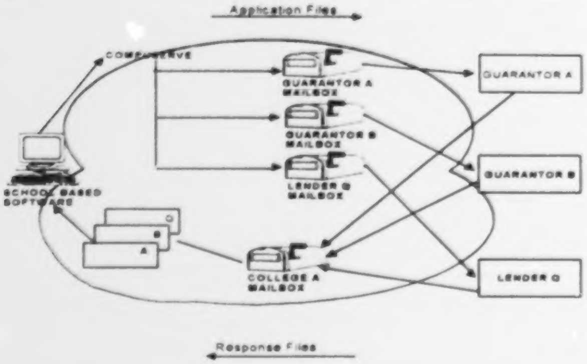
A. Multiple Formats



Before the establishment of common formats and a common data transmission mechanism, one school could have multiple School Based Software (SBS) systems in house using multiple formats to transmit data to guarantors, lenders, and servicers. For example, they might have SBS-A loaded on one PC to communicate with Guarantor A, SBS-B on another PC to communicate with Lender B, and they might be communicating with other guarantors and lenders via paper, rather than via an electronic connection.

The goal of the CommonLine Network is to make things simpler for the school by (1) establishing standardized formats, (2) allowing them to use just one SBS system to communicate with all participants in CommonLine, eliminating multiple SBS systems, and (3) allowing them to use that single system to communicate with organizations with which they currently have no electronic connection.

B. CommonLine Network - One School


Application Files
COMPUSERVE
GUARANTOR A MAILBOX
GUARANTOR B MAILBOX
LENDER C MAILBOX
SCHOOL BASED SOFTWARE
GUARANTOR A
GUARANTOR B
LENDER C
C
B
A
COLLEGE A MAILBOX
Response Files

With active participation by guarantors and lenders in CommonLine, schools will be able to use just one School Based Software (SBS) system to transmit application data to multiple guarantors, lenders, and servicers. School staff will make just one transmission, which will contain a separate file for each recipient, to CompuServe. The separate files will be dropped into the mailboxes owned by the recipients, similar to the way a mailman drops packages into home mailboxes. In this fashion, only the intended recipient has access to the data files.

Recipients will access CompuServe to "pick up their mail," by retrieving the packages of data files which have been dropped off by the schools. Lender participants will exchange data with guarantee agencies to obtain necessary guarantee information.

After processing, the guarantors, lenders, and servicers will send response data back to the school through CompuServe. Each recipient of the application data will respond separately, transmitting a data file to CompuServe, leaving a "package" in the mailbox owned by the school. The school staff will dial into CompuServe to pick up their mail, retrieving an individual file from each sender, in just one retrieval transmission.

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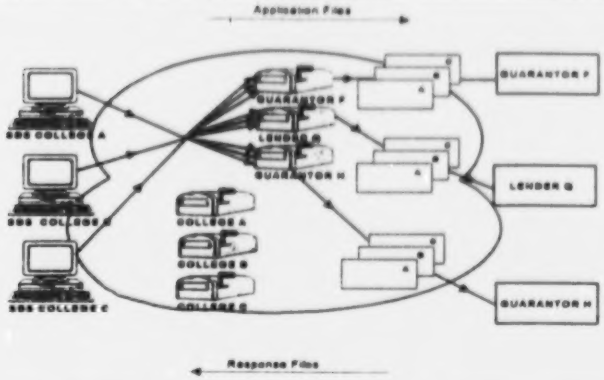
C. CommonLine Network - Multiple Schools Transmission to Recipients


Application Files
SBS COLLEGE A
SBS COLLEGE B
SBS COLLEGE C
GUARANTOR F
LENDER G
GUARANTOR H
COLLEGE A
COLLEGE B
COLLEGE C
GUARANTOR F
LENDER G
GUARANTOR H
Response Files

With active participation by vendors of School Based Software (SBS), it is now possible for each school to select just one SBS system to transmit and receive electronic application data to guarantors, lenders, and servicers. Each school will make its own selection, so there will remain many different SBS systems, but each will interact via CommonLine similarly.

Staff at each school will make just one transmission, which will contain a separate file for each recipient, to CompuServe. Each school's separate file will be dropped into the mailboxes owned by the recipients, similar to the way a mailman drops packages into home mailboxes. In this fashion, only the intended recipient has access to the data files. Throughout a typical day, as demonstrated on the diagram, packages of data will collect in the recipients' mailboxes from all participating schools.

Recipients will access CompuServe to "pick up their mail," by retrieving the packages of data files which have been dropped off by the schools. All packages are retrieved concurrently via one retrieval transmission.

1 Recipient Logic Recommendations

School based software should be modified to determine both the electronic file recipients (CompuServe mailbox address) and the physical document recipients (mailing address for paper that follows the electronic transmission). **This outline suggests the logical-level issues related to this determination, leaving the physical implementation in the software up to each school based software vendor.**

a Setup Function - Electronic File: Software should include a school set-up function which allows schools to determine the electronic file recipients based on lender and guarantor. To eliminate the need to create a table of excessive size, the logic of this set-up function could be designed in an "exception" fashion. The standard practice is to send the application to the guarantor identified. The exceptions are those cases where the recipient is **not** the guarantor for all loans for a certain lender would need to be entered. The logic of the software would then use the guarantor as the recipient if the lender on a record is not found on the table or if no lender is identified on the record.

The example table below shows a school with four examples of "exceptions to the rule" that most applications are generated to the guarantor identified.

- Loans for Lender 800012 are transmitted to "Lender A", rather than the guarantor, regardless of the guarantor identified.
- Loans for Lender 811112 are divided:
  - Those identified as "Guarantor A" are sent to "Servicer A"
  - Those identified as "Guarantor X" are sent to "Servicer B".
  - All other Loans, with any other guarantor identified, are sent to the specified guarantor.
- Loans for Lender 877772 are transmitted to "Servicer A" rather than the guarantor, regardless of the guarantor identified.

Table A - Recipient Deviation Table

Lender Code	Guarantor Code	Electronic File Recipient Abbreviation
800012	All	LNDA
811112	Guarantor A	SRVA
811112	Guarantor X	SRVB
877772	All	SRVA

b. Setup Function - Physical Documentation: Software should also include a school set-up function which allows schools to determine the physical documentation recipient based on lender and guarantor. This recipient will inform school staff where to send paper documentation after entry of the corresponding electronic data into the CommonLine Network. Because the two (data and paper) do not always go together, it is necessary to treat the determination of the physical document mailing address separately, at least from a logical point of view. Obviously, some vendors may choose to create only one table or database structure which stores both (electronic and physical) recipient.

c. Recipients Determination: Software should automatically determine and inform school personnel of the correct recipients for each record using the set-up data entered by the school. For example, it may be appropriate for the software to notify a user who is entering application data one student at a time where the physical documentation is to be sent, so the user can sort his or her work at the time of entry. If the school based software includes a transmittal report or letter to accompany the documentation, it will obviously need to use the correct address for the physical documentation recipient.

d. Mailbox Address: In order to insulate school staff from the necessity to know and correctly type each mailbox address, an internal table could be created to store the recipient abbreviation, name, and mailbox address. This table must be user maintainable to allow for addition and deletion of participants. The four-character abbreviation is part of the CommonLine application file layout and will be determined by each participant; a listing of valid values will be included with each revision of the file layout descriptions. For example:

Table B - Electronic File Recipient Code Table

Recipient ID (Destination ID, Field 18 of Header Record)	Recipient (Destination Name, Field 17 of Header Record)	·Recipient Mailbox Identification
899000	Mideast Guarantee Services	71741,259
898000	State Guarantee Agency	59168,439
897000	Southeastern Agency	21594,116
123456	Northwest Servicer	23161,882

2. There are many ways to physically implement the logic described previously. As an **example**, the following illustrates a physical implementation. For this illustration, using school based software we call "W", four tables would be used as noted.

a. The Guarantor table. This table is a two field table. The first field is an alpha field containing the code for the guarantor. The user will be able to add and change the ED assigned codes for Guarantors in this field. The second field is a 50 character alpha/numeric field. The user will be able to add and change the Guarantor name in this field which corresponds to the ED Guarantor Code. Records may be added or deleted. This table will be used to validate the Guarantor Code entered in an application. It will also be used to validate the Guarantor Code field in the recipient Deviation table. There is a maintenance window for this table. (ED guarantor codes are found in Appendix A of with the NCHELP CommonLine Application File format.)

b. The Lender table. This table is a two field table. The first field is six character numeric data type. The user will be able to add and change the ED assigned codes for Lenders in this field. The second field is 32 character alpha/numeric. The user will be able to add and change the Lender name in this field which corresponds to the ED Lender Code. Records may be added or deleted. This table will be used to validate the Lender Code entered in an application. It will also be used to validate the Lender Code field in the Recipient Deviation table. There is a maintenance window for this table.

c. The Electronic File Recipient Code table. (Table B, page 8) This table contains three fields. The first field is the Electronic File Recipient Code. It is a four character alpha/numeric data type. This field will contain the code used by the logic to select the CompuServe Destination Mailbox ID. This field will also be used to validate the entry in the Electronic File Recipient Code field in the Recipient Deviation table. The second field is a 50 character alpha/numeric data type. It contains the Recipient Name. The field is used for reference only. The third field is a 50 character alpha/numeric data type. This field contains the CompuServe Destination Mailbox ID used to address mail for CompuServe Mailboxes. There is a maintenance window for this table.

d. The Recipient Deviation table. (Table A, page 7) This table contains three fields. It is used to create relationships that deviate from the normal CompuServe Mailbox relationship for Guarantors. For example, this table would be used to route an application to a servicer whose Guarantor also participates in CommonLine, but the Lender desires to use the servicer for processing. It could also be used to send applications for a given Lender to that Lender's CompuServe Mailbox. This table contains three fields. **The first field** contains the Lender Code. This field is validated by the Lender Code field in the Lender table. **The second field** contains the Guarantor Code. It is validated by the Guarantor Code in the Guarantor table. **The third field** is the Electronic File Recipient Code. It is validated by the Electronic File Recipient Code field in the Electronic File Recipient Code table. Records in this table should be selected from the assocated list, not key entered, to insure all deviations have CompuServe Mailbox IDs. There is a maintenance window for this table.

The software prompts the client during install to determine whether the client will use CommonLine. This (answer) value is stored in an initialization file. During the SAVE functions of IMPORT and ENTRY/EDIT, SBS "W" tests to see if this value is set to YES, applying the following logic:

If it is YES:

Is there an entry in the Recipient Deviation table that matches either (a) both the Lender Code and Guarantor Code or (b) the Lender Code and the value of "all" in the Guarantor Code?

If YES -

Store the value of [Recipient Deviation] [Electronic File Recipient Code] in [Loan][Destination] field. This value will be used at the time of transmission batching to determine destination.

If NO -

Check [Electronic File Recipient Code][Electronic File Recipient Code] field for a match with the Guarantor Code in the application.

If MATCH -

Store Guarantor Code in [Loan][Destination] field.

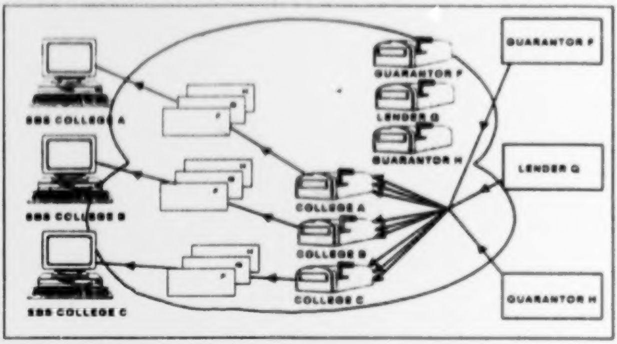
If NO MATCH -

Do not save the application. Show the following ERROR MSG. on screen. GUARANTOR NOT IN ELECTRONIC FILE RECIPIENT CODE TABLE.

If it is NO:

Process for normal transmission to the Guarantor.

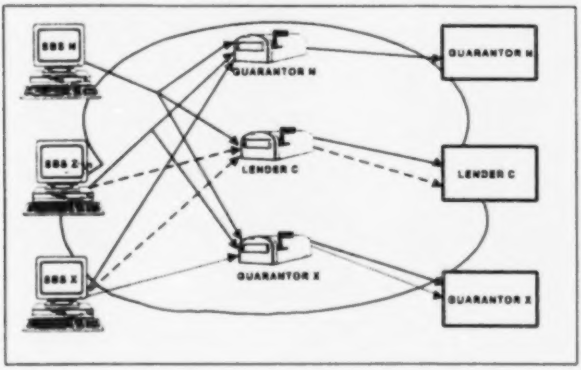
D. CommonLine Network - Multiple Guarantors/Lenders Transmission to Schools


SBS COLLEGE A
SBS COLLEGE B
SBS COLLEGE C
F
Q
H
GUARANTOR F
LENDER Q
GUARANTOR H
COLLEGE A
COLLEGE B
COLLEGE C
GUARANTOR F
LENDER Q
GUARANTOR H

After processing, the guarantors, lenders, and servicers will send response data back to the school through CompuServe. Each recipient of the application data will respond separately, transmitting a data file to CompuServe, leaving a "package" in the mailbox owned by the school. As demonstrated on the diagram, Guarantor F, Lender Q, and Guarantor H each make one transmission to CompuServe which contains mail packets for College A, College B, and College C.

Each school's staff will dial into CompuServe to pick up their mail, retrieving an individual file from each sender, in just one retrieval transmission. As demonstrated, each school receives a separate file from Guarantor F, Lender Q, and Guarantor H.

E. CommonLine Network - Unique Data



The standard file formats established by NCHELP contain three sections of data: baseline, special services, and unique.

Participants in CommonLine will support the processing of guarantee applications using just the baseline data elements in the established NCHELP CommonLine file formats. Therefore, participant vendors of School Based Software will modify their systems to transmit the standard application format and to receive back the standard response format. Participant guarantors, lenders, and servicers will modify their mainframe systems to receive the standard application format and process guarantee applications, and to generate the standard response format back to the schools. (Demonstrated in the solid line above.) Notice that all SBS systems and all data recipients participate using the baseline data.

Concurrently, many participants will elect to use a combination of the standard data elements ("baseline data") defined in the NCHELP CommonLine format in addition to a small number of recommended data elements ("special services data") accommodated by this format. The "special services data" section includes certain data elements which are not absolutely necessary for guarantee but which allow the participant to provide enhanced services to schools. As reflected in the above graphic, only some SBS systems and some data recipients participate using both baseline and special services data. (Solid lines indicate baseline data; dashed lines indicate baseline and special services data.)

Still further, an SBS vendor who is also a recipient (guarantor, lender, or servicer) has the option of collecting unique data in the "unique data" section of the NCHELP CommonLine format for transmission of data between its own SBS and its in-house guarantee system. This unique file format could include all the baseline and services data and data specified by the vendor/recipient, referred to as "unique" data. The benefit of this approach (rather than a wholly proprietary format) is the simplification of the formats which have to be supported by vendors of SBS systems and by schools who maintain computer systems of their own. (This is shown in the above graphic as short dashes going from SBS X to Guarantor X.) These unique formats may be shared among industry participants. Some school software providers may support more than one "unique" file definition.

F. File Organization

1. Application File

The Application File contains the following records, in this order:

- one Header Record ("@H" Record)
- for each loan or loan application,
  - one Application Detail Record ("@1" Detail Record)
  - in only certain cases, one Unique Supplemental Detail Record ("@2" Detail Record)
- one Trailer Record ("@T" Record)

Data in the Application Detail Record is divided into three groups. The first group, BASELINE FIELDS, reflects data that *must* be included in data exchanged for the guarantee process. The second group, SPECIAL SERVICES FIELDS, contains optional fields used by many organizations to collect data used to provide value-added services. The third group, UNIQUE FIELDS, reflects data unique to the data entry software used to collect it.

When new loan applications are submitted in this file, all detail records should be created at the application level (i.e., one detail record per loan application). However, when certain special services are used (e.g., updates or cancels to loan applications), detail records may be created at the loan level.

When applicable, one or more Unique Supplemental Detail Records for each loan *or* loan application are included *when the institution wishes to use additional unique services provided by the receiving organization.* When used, the Unique Supplemental Detail Record(s) must immediately follow the corresponding Application Detail Record.

Most value added services are provided for in the SPECIAL SERVICES and UNIQUE FIELDS areas at the end of each Application Detail Record. However, some additional unique services require the inclusion of a Unique Supplemental Detail Record(s) for each loan or loan application.

Institutions should be asked to communicate with receiving organizations for detailed information when special services or supplemental services are desired.

2. Response File

The Response File contains the following records, in this order:

- one Header Record ("@H" Record)
- for each loan or loan application,
  - one Application Detail Record ("@1" Detail Record)
  - in only certain cases, one Unique Supplemental Detail Record ("@2" Detail Record)
  - in only certain cases, one Error Messages Detail Record ("@3" Detail Record)
- one Trailer Record ("@T" Record)

Data in the Response Detail Record is divided into three groups. The first group, BASELINE FIELDS, reflects data that *must* be included in data exchanged for the guarantee process. The second group, SPECIAL SERVICES FIELDS, contains optional fields used by many organizations to collect data used to provide value-added services. The third group, UNIQUE FIELDS, reflects data unique to the software used to create it.

This file may contain detail records at both the loan and the loan application levels. If a loan application has guaranteed, there will be one detail record for each corresponding loan. If a loan application is pending or rejected, there may be one detail record for the application *or* one detail record for each corresponding loan, depending upon the sending organization's approach. Additionally, this file may contain detail records at the loan or loan application level if certain special services are being utilized (e.g., modifications to previously submitted loan applications).

One or more Unique Supplemental Detail Records (@2 detail records) for each loan *or* loan application are included *if additional unique services provided by the sending organization are being utilized.* When used, the Unique Supplemental Detail Record(s) must immediately follow the corresponding Response Detail Record.

Most special services are provided for in the SPECIAL SERVICES and UNIQUE FIELDS areas at the end of each Response Detail Record.

However, some additional unique services require the inclusion of a Unique Supplemental Detail Record(s) for each loan or loan application.

Institutions should be asked to contact receiving organizations for detailed information when special services or supplemental services are desired.

One Error Messages Detail Record for each loan or loan application is included *if errors occurred during processing* and if the processing organization chooses to provide this record. When used, the Error Messages Detail Record must immediately follow the corresponding Response Detail Record or Unique Supplemental Detail Record(s).

This record type is only included *when institutions are using the error message service as provided by the sending organization*.

3. The receiving software will read two data elements in the transmitted file to determine whether to read the data in the unique section of the file. Following are some example scenarios worth noting to explain the manner in which schools and guarantors may recognize data.

- School Based Software (SBS) system "A" sends baseline, special services and unique data. The unique data is identified as "GTRA01". In the Application File, this identifier can be found in field 82 (Unique Layout Software Vendor Code) and field 83 (Unique Layout Identifier Code).

    a. Guarantor A will process using the baseline, special services and the GTRA01 unique data.
    b. Guarantor B may process using the baseline and special services data, but ignore the unique data.
    c. Guarantor C may process using only the baseline data, ignoring the special services and unique data.

- The Guarantors will respond with a response file and may be sending data back to more than one SBS. Following are some possible combinations.

    Guarantor A above (who read the baseline, special services and unique data) will respond back to the schools who will use the data in differing ways. Guarantor A sends unique data in the GTRA01 format within the Response File.

    a. School A processes using the baseline, special services and unique data.
    b. School B processes using the baseline and special services data, but ignores the unique data.

c. School C processes using the baseline data, but ignores the special services and unique data.

Guarantor B above (who read the baseline and special services data and ignored the unique data) may like the idea of unique data and choose to respond back with their own unique data, identified as GTRB01 unique data. The schools may read the data in these possible combinations:

a. School A processes using the baseline and special services data, but ignores the unique data, being unfamiliar with "GTRB01" data.
b. School B processes using the baseline, special services and GTRB01 unique data.
c. School C processes using the baseline data, but ignores the special services and unique data.

Guarantor C (using software provided by Guarantor C) above who read only the baseline data and ignored the special services and unique data likes only the baseline data and responds to the schools with only baseline data. The schools may treat the data in one of these ways:

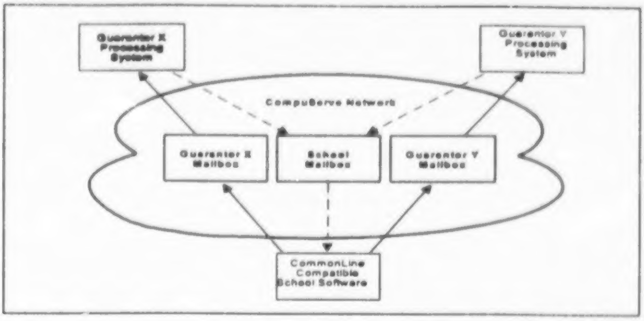
a. School A processes using the baseline data and finds nothing there for special services and unique data.
b. School B processes using the baseline data and finds nothing there for special services and unique data.
c. School C, (using software provided by Guarantor C) processes using the baseline data and expects nothing for special services and unique data.

III. CompuServe Operations

A. After considerable review of the telecommunications options, CompuServe Mail Services was chosen for the exchange of NCHELP FFELP CommonLine Network formats between participating schools, lenders, guarantors, and servicers.

In order to participate in the NCHELP FFELP CommonLine Network it will be necessary to modify existing systems to communicate with CompuServe Mail Services. This will include originating school and lender systems and the receiving systems at guaranty agencies, lenders, and servicers.

B CompuServe Store and Forward


Guarantor X
Processing
System
Guarantor Y
Processing
System
CompuServe Network
Guarantor X
Mailbox
School
Mailbox
Guarantor Y
Mailbox
CommonLine
Compatible
School Software

CompuServe's "store and forward" process provides a storage area for files that pass from
one institution to the next. As the service name implies, CompuServe stores and then allows for the forwarding of that information to the proper recipient through the CompuServe mailbox system.

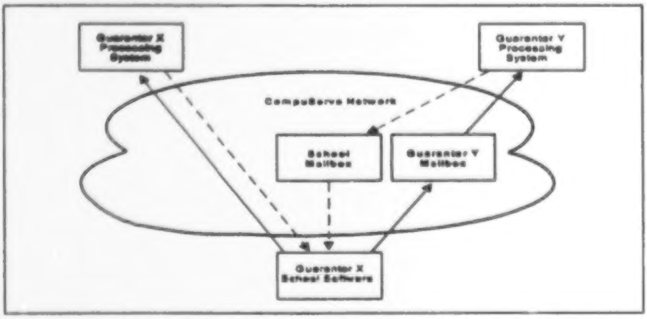
CompuServe's store and forward process will work within several different protocols:

CompuServe B
XModem
YModem
Capture
Kermit
No Protocol

Implementing the protocol desired can be accomplished by using communications packages such as CompuServe's TMail, Procomm, Smartcom, and Crosstalk or by directly imbedding the protocol (like PDQ Comm) within third party software.

In order to use CompuServe's store and forward for the CommonLine Network, a CompuServe mailbox is necessary. Current monthly access fee is $9.95 per month which provides the user with their own mailbox as well as a $9.00 CompuServe E-Mail credit per month. Message delivery fees are $.10 for the first 7,500 characters and $.02 for each additional 7,500 characters. In this equation, 30 NCHELP CommonLine Application File records each 880 characters long will cost less than $.005 per record to deliver.

C. CompuServe Pass Through


Guarantor X Processing System
Guarantor Y Processing System
CompuServe Network
School Mailbox
Guarantor Y Mailbox
Guarantor X School Software

Use of direct electronic linkages may be appropriate when high volumes of data are being exchanged between any two participants. Data goes directly from one participant to another in this option; no mailboxes are used.

One example of this is CompuServe's "pass through" capability which allows support for existing communication methods as well as the development of communication methods not compatible with the store and forward approach such as high volume operations. Similar capabilities are available through other value added networks.

Costs per pass through will vary based on speed of the linkage, volume of data and the term of contract. Generally, there are higher fixed costs and lower per record costs. With enough volume, the costs will be equal to or less than the store and forward process.

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D The following is a preliminary list of information to assist you in getting access to CompuServe and utilizing it for this network:

Available software for PC products:

- CompuServe TMAIL. Product is available for DOS and Windows. Product allows the automation of sending and receiving information via CompuServe. Product is available for a one time $100 fee which gives you support and distribution rights.

- Other file transfer packages can be used, but TMAIL is the only fully supported package for CompuServe.

Subject Names:

The subject names used by all participants must be the same for all information exchanged.

Application File: COMMON APPS
Response File: COMMON RESP

Participants who generate other files along with COMMON APPS and COMMON RESP should use their "PARTICIPANT ID NUMBER" as the first six characters of the subject name to eliminate any chance of duplicate subject names.

Central Contact at CompuServe:

Rick Wentz (703) 827-9075

General Networking Information:

Bruce Young, Sallie Mae (703) 834-5768
Larry DesJardines, USA GROUP (317) 578-6818

IV. CommonLine Implementation

A. Process Overview

For the process to work, it is important that school based software be modified to allow for use of the new formats, input of applications for multiple participating guarantors, and transmission of this data to and from appropriate CompuServe mailboxes. Following are the steps necessary to guarantee a loan using the FFELP CommonLine Network:

- Student Loan certification data is entered at the school using school based software which includes the FFELP CommonLine Network capability.
- The software sorts data records by guarantor and/or lender and, when the school is ready to transmit, the software dials CompuServe.
- Certification data in the FFELP CommonLine Network Application File format is transmitted to the appropriate CompuServe mailboxes for recipient guarantors, lenders, and servicers.
- Recipients draw down the data and process it for guarantee.
- The recipient sorts response records by school and batches them for transmission.
- Processor software connects with CompuServe and places guarantee response data in the FFELP CommonLine Response File format into the appropriate school mailboxes.
- Schools draw down the guarantee response data into their software (PC or Mainframe) for processing, packaging, etc.

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B. **School Based Software Changes**

Listed below are some examples of software changes to be made on those systems used by schools:

1. Areas to be Considered for change in the Transmission of Data

   a. Entry/Edit - change to determine to correct destination before saving a record for transmission.

   b. Import - change to determine to correct destination before saving a record for transmission.

   c. Batching - a change should be made to group records into multiple individual files based upon destination. (Most existing software batches records into one file for one destination.)

   d. Communications - change to dial CompuServe and deliver mail to each destination's mailbox.

   e. File Formats - change to transmitting the new CommonLine application file format.

2. Areas to be Considered for change in the Receipt of Data

   a. Communications - change to dial CompuServe and retrieve mail from the institution's mailbox.

   b. Reporting - change to print Response file using the new CommonLine response file format.

   c. File Formats - Change to receive using the new CommonLine Response File format.

3. Other Additional Considerations

   a. Lender/Guarantor cross reference window - to allow the entry of a recipient for both paper and electronic applications. Fields contained on this window would include: lender code, guarantor code, electronic application destination ID, paper application destination ID.

   b. Logical to Physical Address translation window - to provide for the translation of logical four-character mailbox IDs to physical CompuServe mailbox IDs. Fields contained on this window would include: descriptive destination name, four character symbolic destination ID, CompuServe mailbox address.

C. Mainframe (Home System) Changes

Listed below are potential changes to be made to the "home" systems of lenders, guarantors, and servicers.

1. Changes needed as a result of receiving information through the CommonLine Response file include categorizing all error messages into the five baseline error messages reported through the response file.

2. Other changes focus on conversion of data into acceptable formats for mainframe processing.

D. Participation Checklist

Modify Your Software To:

I. Accept CommonLine Application Files
II. (Also) Transmit CommonLine Response Files
III. (Also) Modify School Based Software

(participation level determined by participant)

Obtain CompuServe Mailbox for Receipt of Data from Schools

Certification:

Certification of your own software changes is self-managed rather than provided by an external entity.

For guarantor, lender and servicer systems:
using test data and test plans provided by NCHELP ensure that your software changes meet specifications for receipt of Application Files and creation of Response Files.

For School Based Software systems (if applicable):

Using test data and test plans provided by NCHELP ensure that your software changes meet specifications for generation of Application Files and receipt of Response Files.

Complete Your Participant Profile:

The Participant Profile provides a standard way to represent information about each CommonLine participant which is of interest to all other participants who are electronic trading partners. It includes information such as identification of participant organization name, individual contact names and addresses, services supported, and software utilized or provided.

School Outreach & Education:

- Provide school with list of participating CommonLine recipients.
- Instruct school on obtaining school CompuServe mailbox.
- Instruct school on completion of school Participant Profile.
- Instruct school on establishing trading relationships with new recipients.

Test School Based Software Systems of Others:

For each School Based Software system used by new school customers, establish test plans and data to ensure that other vendors' SBS systems meet specifications for generation of Application Files and receipt of Response Files.

Establish New School Relationships:

For each new school customer (a school which does not currently transmit data to your organization in a proprietary data format), obtain an electronic certification agreement.

E. Contact Names

Further information and technical assistance may be obtained by contacting the following persons:

Jim Moran	Texas Guarantee Student Loan Corporation	(512) 219-4624
Caron Peterson	Colorado Student Loan Program	(303) 294-5050 ext 304
Shelley Cowan	Northwest Education Loan Association	(205) 461-5426
Tom Wenman	Vermont Student Assistance Corporation	(802) 654-3728
Jon Kroehler	USA Services	(317) 595-7122
Laurie Campbell	Sallie Mae	(202) 298-2684

TESTIMONY TO THE ADVISORY COMMITTEE ON STUDENT FINANCIAL ASSISTANCE
APRIL 11, 1995

Good Afternoon. My name is Lydia Marshall and I am the Executive Vice President for Marketing at Sallie Mae. I appreciate the opportunity to be part of this panel discussion to explore improvements to FFELP because we have common objectives: Serving the needs of student borrowers and serving the Financial Aid Administrators who support them. Members of the FFELP industry have taken significant strides to improve processes and products to meet these goals. Sallie Mae is proud of the innovations and industry initiatives in which we have played a role, some of which I will describe to you today.

Most of you are familiar with Sallie Mae in its secondary market capacity as the provider of liquidity to support educational credit. What may not be as apparent is our evolving approach to this business. The early years of Sallie Mae were dedicated to supporting our loan purchase responsibility. This entailed developing computer systems and processes, hiring and training staff and writing policies and procedures to create an infrastructure so that we could buy loans from lenders efficiently and service student loans effectively. This was a significant undertaking, but one that has resulted in an organization that successfully accomplishes these goals.

With that important challenge completed, we began in the late 1980s to focus our attention on the growing needs of financial aid offices at colleges and universities. As you know, the financial aid office directs many of the activities for the FFELP programs by determining student eligibility, by counseling students on loans and lender selections and by certifying applications. As an entity serving a national market, we endeavor to bring solutions which meet the broad needs of financial aid offices and students.

Sallie Mae is not, of course, the only one seeking to provide more comprehensive services to institutions of higher learning. In fact, there is considerable competition in this arena, and certainly direct lending has added another dimension to it. But direct lending is not the sole reason for our product initiatives. We believe that focusing on streamlining the loan delivery process at colleges and universities, providing high quality products and services to financial aid administrators, and helping families and students better afford the costs of education are a natural evolution in our business and in our mission. I am also pleased to add that Sallie Mae has benefitted from the wisdom of a Financial Aid Advisory Council that provides guidance on our approach to these initiatives.

I have been asked to discuss FFELP features, specifically single source borrowing and standard terms and conditions for student loan repayment. I will speak generally of these issues from a Sallie Mae product and service perspective although many, if not most, industry participants have similar offerings.

Single Source Borrowing

The notion of single source borrowing is overwhelmingly the outcome of split borrower accounts. Loans held by multiple lenders were the bane of student loan servicers because they made life difficult for borrowers and financial aid administrators. The industry was not, at the time, sophisticated enough to service multiple loans as if they were one. The problem was exacerbated when lenders varied their approach on holding or selling loans.

Sallie Mae solved this problem some time ago. It is our philosophy to recommend that borrowers stay with their original lender. It is our policy to combine all FFELP loans under one account. How do we do this? Sallie Mae's single source product, ExportSS, provides lenders with life of the loan servicing capabilities. For lenders who do not use ExportSS, we check for split accounts prior to purchase and our system allows us to manage all FFELP loans as one account regardless of the lender/guarantor combination. In cases where split account servicing occurs because we do not own the loans, we work with other holders to sell or purchase individual loans. In addition, we have put in place "swap" arrangements with other holders to transfer entire portfolios of loans.

These capabilities are important because single source borrowing is limited in its ability to solve the problem for all students and aid administrators. Students do transfer to schools that are not serviced by their original lenders or guarantors. In other cases, borrowers decide to switch lenders because of benefits they desire or because they become unhappy with the level of service they are receiving. Also, in cases where a lender leaves the program, the borrower may have to find another lender.

Many of the same reasons for providing alternatives to single source borrowing apply to the financial aid administrator as well. Many institutions deal with a single set of lenders and guarantors as a means of controlling loan delivery and service. However, schools modify their lists of preferred lenders and guarantors because of the same needs and motivations previously cited for borrowers.

It is critical for our industry to find solutions which enable borrowers and schools to maintain original lenders and guarantors or switch. We should not encourage a process that forces them to stay with one provider regardless of its performance. We think the introduction of the CommonLine^{SM} network is a recent example of the industry's ability to support choice with standardization. We know that most administrators recommend that students stay with the same lenders for all loans. As you may have heard earlier, CommonLine facilitates this because all loans are processed in the same way. By the same token, schools and borrowers can select different lenders without a change in process and take comfort that the loan will be serviced properly, as one account.

It is innovations like these which are the result of competition and the industry's commitment to providing choice. This is a key strength of the FFELP.

Repayment Options

Sallie Mae's focus is to provide borrowers with a broad array of repayment alternatives. Our approach is to develop innovative solutions within the context of legislated parameters. I know that you are aware of Sallie Mae's Select Your Terms^{SM} service, our repayment plans like the SMART LOAN® and Income Sensitive Accounts and our programs like Great Returns^{SM} and Great Rewards^{SM} which are designed to incent borrowers to repay.

The call by some for common products, forms, and terms and conditions is troublesome. In general, we are very concerned that too much emphasis on commonality denies the value of innovation and competition. Often it limits borrower choices to the least common denominator.

The Loan Consolidation Common Application is a case in point. In its effort to standardize this form, the Department of Education proposes to limit the number of repayment options to three: Standard, Graduated and Income Sensitive. We think this puts the prospective borrower at a disadvantage because it does not allow Sallie Mae and other lenders to disclose additional plans. Sallie Mae for example, has varieties of graduated repayment and has a separate plan for HEAL borrowers. Since the Department of Education's proposal would not include these alternatives, Sallie Mae and the borrower are forced to take additional steps and additional time to put a new payment plan in place.

We have other issues with the common consolidation form and we are working with the Department of Education on them. We support the use of common definitions and other standardization efforts, particularly where the school is in the middle of the process. In fact, we have made our algorithms for Income Sensitive and Graduated Repayment accounts available to industry participants. However, for products geared to consumers, we feel strongly that it is wrong to deprive them of financial alternatives which may improve their ability to repay.

In closing, I would like to thank the committee for this opportunity. It is obvious that FFELP participants are intent on solving problems and I see us working together in a way that will satisfy schools and borrowers. Whether this energy comes from long term strategies or is a response to direct lending isn't really important. Sallie Mae, in the last two years, has introduced more than a dozen new products and services. I would expect that trend to continue.

4/10/95

Streamlining Student Loan Processing
in the
Federal Family Education Loan Program

Submitted by:

The New York State Higher Education Services Corporation
(NYSHESC)

to the

Advisory Committee for Student Financial Assistance

April 11, 1995

Introduction

There has been much time and attention devoted toward finding ways to streamline the Federal Family Education Loan (FFEL) Program. The FFEL Program had grown in complexity as it functioned for nearly 30 years without fundamental change in how applications are processed. While the Federal Direct Student Loan (FDSL) Program was initially developed in response to the complexities of FFELP, it is becoming clear that superior improvements can be made within FFEL instead of its wholesale replacement with FDSL.

This paper outlines a student loan process that is being used now by the New York State Higher Education Services Corporation (NYSHESC) that relies on maximum electronic processing by schools. Important components are: (1) approving a loan application via an electronic record forwarded by the school; (2) using electronics to transmit disbursements; and (3) using an electronic clearinghouse for in-school status certification.

The electronic process highlighted in this paper provides schools with a superior, less costly system of student loan management than other options. It is compatible with "Commonline" and "ELM" and will function within any guarantor's electronic system. Therefore, it addresses a major concern of schools--working with multiple guarantors--by permitting schools to send information in one electronic format to one location. It also addresses a second school concern, by allowing schools to work with three or four preferred lenders _of their choice_. By doing so, FFELP is the only major student loan program where schools get to choose who services the loan.

This paper will contrast three processing options for student loans. The first will be a traditional GSL/FFEL process based on paper. The second process takes advantage of current electronic processing capabilities. The third is the system originally designed for Direct Loans.

NARRATIVE DESCRIPTIONS OF THE THREE PROCESSING OPTIONS

Paper-Based GSL/FFEL

In the past, under this methodology, a student completed his or her section of the application and forwarded the application to the school. The school completed its portion of the application and mailed it to the lender. Upon receipt of the application, the lender completed the lender section of the application and mailed it to the guarantee agency for approval. Upon approval, the guarantee agency sent approval notices to the lender, student, and school. The lender then produced a check co-payable to the student and school and mailed that check to the school. The school then had the student endorse the check, credited the student's account, and refunded any amounts due to the student or the lender.

Periodically, the school was required to verify the student's enrollment status by completing a paper Student Status Confirmation Report and returning it to the guarantor for processing. The guarantor then forwarded a notice to the lender for every change in enrollment status reported by the school.

Electronic FFEL Process

This system utilizes state-of-the-art electronic communication facilities to streamline the application process and to remove the unnecessary handling of paper. Under this process the school submits data electronically to the guarantor regarding the student and school section of the application. The guarantor pre-approves the loan and provides the results to the school electronically. The guarantor then prints the application/promissory note and forwards it to the student for completion (typically signature and perhaps reference information). The student returns the application/promissory note to the guarantor.

Upon receipt, the eligibility of the student is confirmed, and the lender and school are notified of the guarantee electronically. The student receives a paper approval notice. Using the disbursement schedule established by the school in the original application/ promissory note data transmission, the lender then disburses the student loan funds to the school through electronic funds transfer (EFT) for credit to the student's account. Any refund to the lender can be transmitted electronically by the school.

On a monthly basis, the school downloads its enrollment records to the Student Loan Clearinghouse, which in turn reports any changes in enrollment status electronically to the guarantor.

Direct Loan Process

Under the Direct Loan process, the school establishes an origination record with the Direct Loan servicer and prints a promissory note for the student. The school then sends the promissory note to the student for signature. Upon return, the promissory note is processed and transmitted to the servicer. The school then also sends the loan origination record to the servicer. The school then must determine its funding needs and request funds from the Department of Education. Upon receipt of those funds, the school reverifies the student's loan eligibility and records the disbursement information on the disbursement record and transmits that record to the servicer. Periodically, the school must reconcile disbursements and promissory notes with the servicer.

Periodically the school will receive information from the National Student Loan Data System (NSLDS) requesting verification of the enrollment status of all student borrowers. The school will have to review each record and reply to NSLDS.

The chart in the Appendix summarizes the processing requirements for the schools under the three methodologies described above.

Summary

All of the components within the Electronic FFEL Process are in place and working. Our agency has moved through a pilot test of the Pre-approved Application For Loan (PAL) system. We already have one-third of the school loan inputs and one-quarter of the disbursements handled electronically. And, the Clearinghouse, Commonline and ELM systems are functioning in either full-scale use, or beta test sites.

We feel that the system requirements are simpler and cheaper for schools under the Electronic FFEL Process. And, we feel that taxpayer accountability and program integrity are superior within the Electronic FFEL Process. The guarantor can approve loans at several schools for one student per term; however, it will guarantee only one loan, and guarantee must precede disbursement. By comparison, under direct loans, approval and disbursement can occur several times at several schools for the same student and term.

In summary, the Electronic FFEL Process can result in a paperless process for the schools (with the exception of refund checks for students when needed). It is superior to other models in terms of simplicity, cost, and integrity, and is worthy of support by the Advisory Committee for Student Financial Assistance.

Appendix A, School Activities Under Three Options For Student Loan Processing

PAPER

- **Receive application**
- **Complete school section of application**
- **Send application to lender**
- **Receive Notice of Guarantee**
- **Receive individual check for student**
- **Have student endorse check**
- Credit student's account
- **Refund check to student**
- **Send refund checks to lender**
- **Complete SSCR listing from guarantor**

ELECTRONIC FFELP

- Send application data electronically
- Receive pre-approval electronically
- Receive Funds through EFT
- Credit student's account
- **Refund check to student**
- Refund to lender through EFT
- Download enrollment data to Student Loan Clearinghouse

DIRECT LOANS*

- Establish loan origination record
- **Print and transmit promissory note**
- **Send promissory note to student**
- **Process and transmit promissory notes to servicer**
- Send loan origination record to servicer
- Determine funding needs
- Request drawdown from ED
- Reverify loan eligibility and credit borrower's account
- **Refund check to student**
- Record disbursement information and transmit to servicer
- Reconcile with servicer (p-notes and disbursements
- Complete SSCR received from NSLDS

---

* SOURCE. Direct Loan Task Force Overview - 10/15/93

Boldface indicates that the school performs this function using paper.

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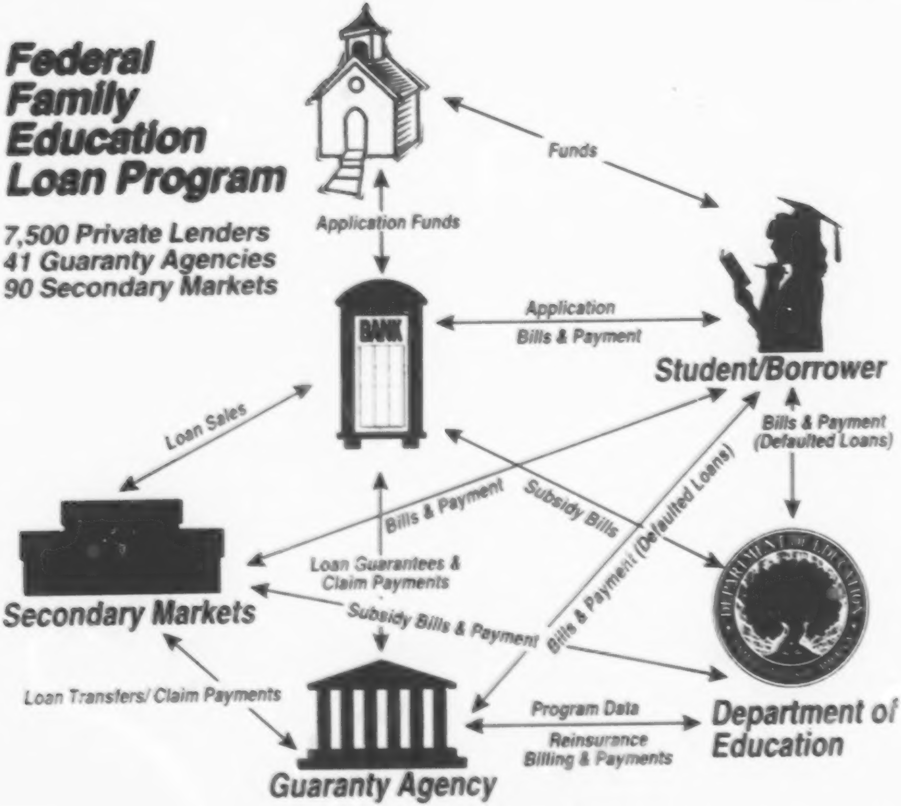
DEPARTMENT OF EDUCATION
UNITED STATES OF AMERICA

Direct Loan Program

March 30, 1995

Federal Family Education Loan Program

7,500 Private Lenders
41 Guaranty Agencies
90 Secondary Markets



Funds

Application Funds

Application

Bills & Payment

Student/Borrower

Bills & Payment (Defaulted Loans)

Loan Sales

Bills & Payment

Subsidy Bills

Bills & Payment (Defaulted Loans)

Loan Guarantees & Claim Payments

Subsidy Bills & Payment

Secondary Markets

Loan Transfers/ Claim Payments

Program Data

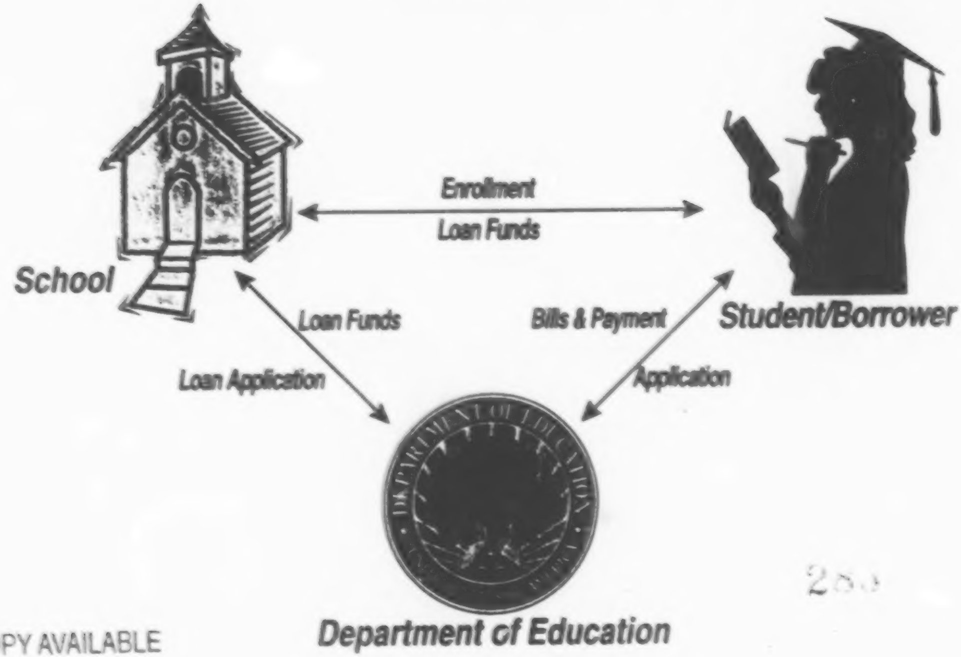
Reinsurance Billing & Payments

Department of Education

Guaranty Agency

Direct Loan Program

5-8 Servicers



School

Enrollment

Loan Funds

Student/Borrower

Loan Funds

Loan Application

Bills & Payment

Application

Department of Education

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John Gritts
Director of Financial Aid
Black Hills State University

First of all I would like to thank the Advisory Committee on Student Financial Assistance for this opportunity to testify about the Federal Family Education Loan Program. As you are already aware, I work at a fairly small four year public institution in South Dakota. Historically, Black Hills State Univeristy, is a teacher's college, and in recent years developed into a four year liberal arts college, with a very limited Master's degree offering.

Black Hills State is a low cost institution, and in this day and age a bargain with undergraduate tuition next year at $50 per credit hour. About 85% of our 4,000 students apply for and qualify for some type of financial aid. This year over 2,300 of our students have qualified for the Federal Stafford Loan and Unsubsidized Stafford Loan. Education Assistance Corporation in Aberdeen, SD, is our appointed State Guarantor. Of the 2,300 borrowers 2100 or over 90% borrow use Education Assistance Corporation as their guarantor. 29% of our students are non resident for tuition purposes, of which 12% of these students come from Wyoming. The rest are from Colorado, Montana, North Dakota, and other surrounding states. Those non resident students use Student Loans of North Dakota, the Montana Guarantee Agency, or Wyoming Student Loans Corporation and USA Funds. Most of our students come from small rural isolated communities with Rapid City, SD, 50 miles away, being the nearest town of any size of 80,000 people. I would not be able to sleep at night if I did not say I am concerned with the amount of loan debts all students have had to incur to finance their educations, but that is an entirely different subject.

When I think of ways we can change or improve the FFEL program, I have to stop and reflect on my own personal experience. Remember I have been at one school for over 20 years, and if you ever visited the Black Hills of South Dakota, you would clearly understand why I have stayed so long. My experience has been with the system we have developed with the cooperation of Education Assistance Corporation and our Computer Center on campus. We have used the Sigma Student Aid Management System (SAMS) for over 8 years. Prior to this we handled our entire student aid program with paper.

Since the beginning of the FFEL program, I have always felt the student should be encouraged to borrow from their local bank. It should serve as a tool for the traditional age student to establish a relationship of their own with the bank, if they had not already been taught that by their parents. Black Hills State has allowed students to select their lender and use their local banks for their FFEL Loans. One of our goals with student borrowing is have our students borrow from one loan source, whether a Federal Perkins Loan or Federal Stafford Loan. If a student transferred to Black Hills State, we encourge the student to stay with their original lender and or guarantor.

I am not sure I have precise plans for simplification to offer the Commission as much as a reflection or review of our current FFEL operations to demonstrate how the program works at our institution. From the beginning we have worked with a Guarantor whose main goal was to help students and institutions. To offer assistance to students in having lenders ready to participate in the program.

The buzz word we can use in South Dakota is "one stop shopping". Students currently apply for federal aid using the FASFAA. Once we have determined their financial aid eligibility, we send an award letter to the student. If the student accepts the award, which may include a Federal Stafford or Unsubsidized Loan, we start our processing. We have to determine if the student is from South Dakota or has used EAC before. We collect this information from the signed award letter asking the student to inform us the lender from which they want to borrow.

If the student wants to borrow out of state, we use a paper Application Promissory Note. If they elect to borrow from a South Dakota lender, using codes in our system, we transmit the pre approved, student accepted award to EAC. EAC then preprints the certified application promissory note and mails to the student.

The student completes their portion of the Application Promissory Note then mails or delivers the application to their lender. This is where South Dakota is unique in Education Assistance Corporation has worked with lenders to establish Education Assistance Services Company Incorporated or EASCI. This wholly owned subsidiary owned by EAC does all the banks or lenders work for them in cutting checks, disbursing the checks to the institutions, answering questions from students and parents, and in general act on behalf of the lenders with the student loans. Since 1985, we have had this service which allows the lenders and EAC to guarantee and disburse loan checks to institutions in 24 hours.

Sigma, our software financial aid program, was to have an automated loan system to use in South Dakota, but our office grew tired of waiting and with the cooperation of EAC and our Computer Center developed our own batch program . I have described this process briefly for you. Other schools in South Dakota have borrowed our system. It eases paper work and we are able to process loans quickly and not have loan applications stacked on our desks waiting for someone to fill in the blanks.

We receive loan checks within 2 to 4 working days once guaranteed by EAC. If we discover after one disbursement we have to make changes, either with a telephone call, or using a software program provided by the Gurantor, we are able to make changes in one day for our students and not get into trouble with over awards. We have been using this program for 4 years. EAC is doing Electronic Funds Transfer with other institutions in South Dakota, and I had hoped we would be participating in this process this fall. We are installing a new accounting system and the business office asked me to wait for one semester to use Electonic Funds Transfer.

The Student Record System we use allows us to determine if a check is at the Business Office. Again with the help of EAC and our Computer Center we have developed a batch job to update the Student aid system to show the loan has been paid or disbursed to the student. Again, a simple process that saved us time in entering data one at a time for updates. We would have to complete this process over 4,000 times if not for the simple exchange of data between EAC and our office. Currently 4 other schools in South Dakota have borrowed and use this process.

We confirm the students enrollment status with the Student Status Confirmation Reports monthly with the EAC. We share the date via tape exchange updating current enrollment status each month from our Student Record System. Again an idea we had and with the cooperation of EAC and Computer Center saved us days on manuel checking. We do not process the long paper print outs we used to do. However with other agencies we still complete the paper rosters. Of course we prefer the automated system, and have not asked other agencies to use our automated process. With the National Data Base Systems coming up, there may not be such a demand for this way of reporting.

We have edits within our system to double check our work. The system we use works on our campus. It allows us to properly disburse funds to students that are eligible for federal aid. We do all of our edits up front, prior to having loan checks, which makes our payment process easy for students to understand.

Another area in which the Guarantor has helped is in the area of compliance and training. Although I am not a real fan of reviews, and not really looking for a program review, our State Guarantor has reviewed my office and the FFEL programs every other year for over 8 years. Granted, they are able to and have assesed liabilities to our institution for non compliance, they have helped us in making sure we are following the rules of the program with the many changes the department has made in past years. This is an area we welcome so know we are following procedures correctly before a review or audit.

Training and technical updates is important. We use the RTDM network for training, and updates. This is important in staying in compliance. Knowing we will be informed and have an opportunity to discuss changes helps us to administer the program.

We have worked with a Guarantor whose main goal was to help students, provide quality service to institutions and service to lenders. In the history of the program in South Dakota, a lender of last resort was never needed. Currently we have over 160 lenders participating in the FFEL Program. The one stop shopping includes guaranteeing the loan and selling to the secondary market, which is also based in South Dakota. The collection of the loans is all local, and the students understand their obligations. Working up front with the borrower and schools make this process easy.

I am anxious to see how standardized forms will help the FFEL Programs. It is obvious with the competition with FFEL and Direct Lending, the FFEL program has improved. I think common forms will make the program easier to administer, and we need more Guarantors that will be willing to listen to Institutions with ideas that make work easier and deliver the needed funds to students.

Being small has it disadvantages and being from a rural area has its drawbacks. But being small has allowed South Dakota and surrounding states make the FFEL program work. If I were at a large institution working with many guarantors, I would not be wearing a long pony tail, have pulled all the hair out of my head a long time ago if it were not for the cooperation we receive from our local Gurantors.

When you evaluate the concept of student financial aid, you will find we are a very young profession. We are providing a very important service to students Students have been able to select, attend and persist with their dreams since 1965. Even though we are young, what is the one factor we can all identify for those of us who have been in the profession for awhile? Change! There is always change, and that not only confuses the aid office, but really confuses students and parents.

We need some time of stability. I think we are going the right direction with common forms, EDE processes, Common reporting especially with automation.

National Association of Graduate-
Professional Students, Inc.

Resolution on Direct Lending

Whereas: We believe that the apparent savings realized from direct lending warrant continuation of the phase-in of this program.

Whereas: Changes in the program's implementation hamper the ability of the Education Department to assess these savings.

Whereas: Concerns raised by many about the cost-effectiveness of the administration of the program and the possible inflation of savings estimates convinces us that proposals to bring 100 percent of the federal student loan program into direct lending are premature.

Whereas: The elimination of most of the existing loan program has the potential to eliminate real competition between the two systems, competition that has the potential to further benefit students.

Therefore be it resolved that:

> The Board of Directors of the National Association of Graduate-Professional Students supports current law on the issue of direct lending.

Adopted by the NAGPS Board of Directors on April 2, 1995.

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RESOLUTION #1
PRINCIPLES WHICH SHOULD BE MAINTAINED IN THE FEDERAL STUDENT LOAN PROGRAMS

There has been a great deal of debate in recent months regarding the Federal Direct Student Loan Program and the Federal Family Education Loan Program. In light of these discussions and pending legislative proposals, the Board of Directors of the National Association of Student Financial Aid Administrators hereby has adopted the following principles which should be maintained.

1. All eligible postsecondary institutions should continue to have the option, based upon the choice of each school, to participate in whole or in part in either the Federal Direct Student Loan Program (FDSLP) or the Federal Family Education Loan Program (FFELP).

2. The number of loans and percentage of loan dollars awarded under the FDSLP or FFELP should not be constrained by imposing limits or volume amounts on either program.

3. Individuals who borrow under either FDSLP or FFELP should be entitled to equivalent terms and benefits, including but not limited to, minimum and maximum annual and cumulative loan limits, interest and fee charges, and deferment and authorized repayment options.

4. In recognition of the effort and commitment put forth by the Department of Education, members of the lending community, and institutions, as a minimum the FDSLP and FFELP should be allowed to continue to operate as parallel programs until their current authorized timelines expire.

Adopted May 2, 1995 in Minneapolis, Minn.
By the NASFAA Board of Directors

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May 19, 1995

The Honorable William Goodling
Chairman - House Committee on
Economic and Educational Opportunity
2181 Rayburn House Office Building
Washington, D.C 20515

Dear Mr Goodling

I am pleased to have the opportunity to submit testimony to the House Committee on Economic and Educational Opportunity in support of the Federal Direct Student Loan Program I recognize that there has been considerable national debate regarding the respective merits of the Federal Family Educational Loan Program and the Direct Loan Each has its strong advocates Both programs collectively assist millions of students, and each participating institution should be free to select the appropriate federal loan delivery for its students and families

The attached statement outlines the exceptionally positive experience that Rutgers, the State University of New Jersey has had during its initial year of activity with the Direct Loan I have also appended an Op-Ed article written by Dr Francis L Lawrence, President, Rutgers, The State University of New Jersey which appeared on April 30th in The Trenton Times which persuasively argues for Direct Lending and the retention of federal student assistance programs

I am urging your support for Direct Lending, and for the opportunity for institutions to have free choice between federal loan deliveries

Sincerely,

John Brugel
University Director of
Financial Aid

Enclosure

lc/gdling

Testimony Provided To The House Committee On Economic and Educational Opportunity

As the University Director of Financial Aid at Rutgers, The State University of New Jersey, I have had an opportunity to examine closely the first year implementation of the Federal Direct Student Loan Program The initial year's operation of this program at the University has been exceptionally positive

I believe that I bring some objectivity to my evaluation as that I only recently joined the University Prior to coming to Rutgers I served at a private university participating in the FFELP and for nearly a decade, served the New Jersey Department of Higher Education as Assistant Chancellor - Student Assistance and Information Systems In this position I was responsible for the New Jersey Higher Education Assistance Authority which supported the Federal Family Educational Loan Program Guarantee Agency Prior to that I was the Director of Student Assistance at the Pennsylvania State University

During my 25 year tenure in financial aid, the growth of the federal loan programs has been steady, and its significance as a funding element in student aid packaging has become prominent Increasing participation and complexity necessitates that we streamline processes and automate fully to best serve students and families

The Rutgers University Direct Lending story can be succinctly told by quoting from a University briefing paper entitled "Direct Lending A Computing Success Story " (See Attached)

> "In November of 1993, Rutgers was accepted by the United States Education Department as one of the first one hundred and five colleges and universities nationally to participate in the new and completely electronic Federal Direct Student Loan Program Under Direct Lending, students borrow money for college directly from the Federal Treasury, as opposed to dealing with private banks and individual state loan guarantee authorities During Rutgers' last year of participation in the Federal Family Educational Loan Program- - the Bank Loan Program which Direct Lending replaced-- our students dealt with over two hundred and eighty different banks and some thirty-four different State Guarantee Authorities, each having its own policy and procedures for processing college loans
>
> Moreover, the process was largely manual, thirteen thousand plus borrowers had to submit paper applications obtained from banks to the aid office The aid office had to complete its portion of the application, while subsequently forwarding them to the State Guarantors The guarantors then forwarded the application on to the banks who would then produce individual checks for each student whose loan had been approved by the school and by the guarantor Finally, since each loan was required by federal regulations to be disbursed in two installments, our Business Offices would receive some twenty-six thousand checks annually - each of which would have to be individually endorsed by the recipient and negotiated by the University "

The Direct Lending Program provides that the student need only file the Free Application for Federal Student Aid (FAFSA), and a one-page Promissory Note - if they wish to accept a loan to assist in their educational financing. The processing is far more efficient - as no separate loan application or check signing is required.

The Rutgers University experience has been exceptionally positive, with much evidence of the program's efficiency and effectiveness. The empirical data upon which the favorable Rutgers University experience is based can be seen by the following comparison:

> By August 12, 1994, the Friday of the week in which Fall, 1994 Term Bills were due, (our first semester of Direct Lending activity) the Financial Aid Office had processed over fifteen thousand Direct Loans. In all fifteen thousand cases, the Direct Loan was available to assist the students in the payment of their Fall Term Bill. A comparison of the previous year's activity under the Federal Family Educational Loan Program identified less than thirty-three hundred Stafford Loan applications, which had been successfully processed by the middle of August. In effect, under the previous delivery, three thousand loans were available to assist, versus the fifteen thousand under the Direct Lending Program. The example of additional loan dollars available, in conjunction with the reduced paper and signing of checks, identifies why the program has been so popular at Rutgers University.

It should be noted that significant efforts are underway to streamline the FFELP to more closely parallel the above benefits identified with Direct Lending. While such efforts should be lauded and supported, redesign of the FFELP delivery should not imperil direct lending.

In summary, the University has through its participation in Direct Lending substantially increased consumer satisfaction for students and families, increased institutional cash flow, responded to a larger number of student requests in a far more timely manner, and elevated the administrative performance associated with the federal loan program.

Clearly, each institution must assess its administrative capability, its student service goals, and available options for administering federal loan programs. I urge the committee to support Direct Lending and to permit institutions free choice in selecting the appropriate mode of federal loan delivery for their students and families.

Submitted by

John F. Brugel, Ed. D.
Rutgers - The State University of
New Jersey

lc/spe

Direct Lending

A Computing Success Story

In November of 1993, Rutgers was accepted by the United States Education Department as one of the first 105 colleges and universities nationally to participate in the new and completely electronic Federal Direct Student Loan Program. Under Direct Lending, students borrow money for college directly from the federal treasury, as opposed to dealing with private banks and individual state loan guarantee authorities. During Rutgers last year of participation in the Federal Family Educational Loan Program -- the bank loan program which Direct Lending replaced -- our students dealt with over 280 different banks and some 34 different state guarantee authorities, each having its own policies and procedures for processing college loans.

Moreover, the process was largely manual. Our 13,000+ borrowers had to submit paper applications obtained from banks to the aid office. The aid office had to complete its portion of the application, while subsequently forwarding them to the state guarantors. The guarantors then forwarded the applications to the banks, who would then produce individual checks for each student whose loan had been approved by the school and by the guarantor. Finally, since each loan was required by federal regulation to be disbursed in two installments, our business offices would receive some 26,000 checks annually, each of which would have to be individually endorsed by the recipient and negotiated by the University.

Under Direct Lending, students deal only with Rutgers' Office of Financial Aid. The aid office deals only with the Direct Lending Service Center, and all processing is done electronically through the telecommunication of data files to and from us and the Service Center. No separate loan applications are required, which saves financial aid a huge processing step, and all funds are transmitted electronically to Rutgers' accounting department from the Education Department's Payment Management System. This eliminates the need to process the 26,000 loan checks. In fact, the only piece of paper involved in Direct Lending is a one-page Promissory Note which students sign and return to the aid office, and which is then forwarded to the Service Center along with an electronically produced Promissory Note manifest.

Since participants were chosen in November of 1993, and schools had to be technically ready to participate by July, 1994, Rutgers was given a very narrow window of opportunity in which to prepare. This presented a huge challenge to RUCS, as well as the various user departments involved. During what amounted to six months (January through June of last year), the aid offices on all three campuses, the six business offices, central accounting, and the registrar's operation had to be networked together with RUCS in order to use the microcomputer software which the Education Department provided for building the Direct Lending database and for transmitting data to and from the Servicer. Equipment configurations had to be evaluated, ordered and installed. Buildings which had absolutely no network connections had to be wired into the RUNet. The Direct Lending software, which was being released by the department in stages had to be evaluated, both as to its basic operation and as to how it could best be integrated with existing mainframe systems used by the University to support financial aid, student accounting, and other applications. Download and upload programs had to be designed and written. Finally, since the decision was made to use Direct Lending as an opportunity to implement substantial improvements in the Student Accounts Receivable system and in Accounts Payable -- as well as in the Financial Aid Management system -- the programming load in these areas grew exponentially. RUCS put together a Direct Lending Technical Implementation Task Force comprised of members from all relevant areas within the department, while at the same time a Policy Implementation Task Force was put together and on which representatives from all the user areas served. The work of both was overseen by a Steering Committee. This was comprised of University Vice Presidents representing the gamut of administrative responsibility.

As this article goes to press, we are pleased to report that almost $80 million in loans to over 15,000 Rutgers students have been made under Direct Lending. All processing deadlines were met, a reliable network was installed and maintained, and all application programming was coded, tested, and put into production.

Direct Lending is hugely popular with students. It has, in fact, dramatically reduced the time and effort it takes to receive a loan. It is hugely popular with the administration in that student service has been enhanced and complaints reduced. It has also been enthusiastically received by the fiscal side of the administration in that much of the $80 million in loan proceeds already resides in University bank accounts. (Whereas under the old program, second semester checks would only now be negotiated.)

In sum, the Direct Lending project is one of the finest available examples of how the intelligent use of computing resources can more efficiently serve the needs of the University community.

RUTGERS

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OP-ED: Proposals in Congress threaten higher education's affordability, access
By Francis L. Lawrence*

Congress is now considering a proposal that could increase the cost of a student loan by 20 to 30 percent. Another measure under consideration would completely eliminate a campus-based federal grant, loan and work program that currently provides $8 million a year to help more than 6,500 middle-income and low-income Rutgers students to finance their education. A third proposal threatens the successful and cost-efficient new Direct Student Loan Program in which Rutgers is one of the first participants.

Penny-wise reductions in the national commitment to student financial aid foolishly reduce the federal government's investment in hard-working middle- and lower-income Americans. An attack on support for higher education is an irrational disinvestment in America's competitive position in the new global economy, in which knowledge -- not raw materials, capital or low-skilled labor -- is the key resource. Finally, in the emerging social order, where inequality based on knowledge is our great social challenge, a retreat from the federal government's commitment to enable all qualified students regardless of income to attend college is a retreat from our commitment to democratic equality of opportunity.

For the past 30 years, the federal government has played an important role in helping Americans afford a college education. Recognizing that an educated public is essential to the strength and growth of democracy and a sound economy, the government has provided grants, loan interest subsidies and other forms of financial aid to college students. The Higher Education Act of 1965, which forms the basis for the current federal student aid system, embodies the belief that all qualified students should be able to attend college, regardless of their financial status. Indeed, most students attending college in America today rely on some form of financial assistance.

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*Francis L. Lawrence is president of Rutgers, The State University of New Jersey.

But the proposals being considered by Congress will make higher education less accessible to students from low- and middle-income families. These proposals, if passed, could force many students into considerably higher debt upon graduation and discourage others from pursuing a college education altogether.

The first of these potentially devastating measures would eliminate the interest subsidy on federal direct loans. Currently, the 7.43 percent interest on these loans is paid by the federal government while the recipients are enrolled in college. Elimination of this subsidy could increase a student's indebtedness by as much as 20 to 30 percent. Take, for example, an undergraduate who borrows the maximum amount allowed for five years and upon graduation obtains a job with an annual income of $24,000. If the loan is unsubsidized (meaning the interest accrues while the borrower is still in school), the loan payments would amount to more than 20 percent of the student's after-tax income.

Put another way, under the current subsidized program, an undergraduate who borrows the maximum amount allowed repays $7,235 more than he or she borrowed over a 10-year repayment period. But, under an unsubsidized program, the same student would repay $11,400 in interest on the same amount borrowed for the same repayment period.

More and more students are relying on loans to finance their education. In 1993-94, 51 percent of all available student aid was in the form of federal loans. Middle-class families, who often do not qualify for grants because of their incomes, will be the hardest hit if this subsidy is eliminated. Ironically, the middle class is the very group that many political leaders have targeted to benefit from proposals to cut government spending.

Most college students and their parents fully expect to incur some debt in exchange for a college education. But eliminating the interest subsidy would place an additional burden on those who graduate and could even force some to drop out of college before earning their degrees.

The passage of a second proposal would create further hardships for many low- and middle-income students. This measure would eliminate campus-based aid programs that are funded by the federal government -- the Supplemental Educational Opportunity Grants (SEOG), the Carl D. Perkins Loans and federal work-study. Here at Rutgers, more than 6,500 students

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are benefiting from these programs. Nationally in 1994, about 697,000 college students received Perkins loans, 713,000 held work-study jobs, and almost a million received grants through the SEOG program.

A third proposal seeks to put the brakes on a successful and efficient method of lending money to college students. Last fall, Rutgers became one of the first schools in the nation to participate in the Federal Direct Student Loan Program. This program allows students to borrow money directly from the Department of Education, rather than through an intermediary, such as a bank, and with less red tape for the applicants and their parents. The Clinton administration has proposed expanding the program to more colleges and universities, but critics are calling for a freeze so that the program can be re-evaluated and possibly dismantled.

At Rutgers, the program has resulted in a faster and less complicated loan process. For example, by Aug. 12 of last year, the week during which fall 1994 term bills were due, Rutgers' Financial Aid Office processed direct loans for more than 15,000 students. At the end of the same period in 1993, only 3,200 loan applications had been processed.

In addition, the direct loan program allows students to receive their funds earlier so they can buy books and other supplies sooner. Loan recipients also pay lower fees on their loans. Taxpayers, too, will see benefits. The program is expected to save about $6.2 billion over five years by eliminating subsidies paid to banks and other agencies that participated in the student loan program.

Higher education is more important than ever today for individuals and for our nation. College graduates earn an average of 70 percent more annually than high school graduates. Economic growth and competitiveness depend on a highly skilled, well-educated workforce.

This country is taking a hard look at how to use its resources wisely and eliminate wasteful or unproductive programs. But we must not indiscriminately cut higher education programs that pay society back many times over their original cost. The loan interest subsidy, campus-based federal aid programs and direct student loans have helped make American higher education accessible, affordable and diverse. Let's not lock our young people out of their best opportunity for a brighter future. Cutting back on student financial aid is one economy America cannot afford.

THE STATE UNIVERSITY OF NEW JERSEY
RUTGERS

BART GORDON
6TH DISTRICT, TENNESSEE
COMMERCE COMMITTEE
SCIENCE COMMITTEE
(ON LEAVE)

Congress of the United States
House of Representatives

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FOR IMMEDIATE RELEASE
April 6, 1995

Contact: Corinne Russell
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DEFAULT RATES CONFIRM MEMBERS' "WORST FEARS":
DIRECT LENDING A HAVEN FOR HIGH-DEFAULT SCHOOLS

Washington, D.C. -- A bi-partisan group of House members today criticized the Department of Education's direct student loan program for providing a safe haven for high default-rate schools.

Congressmen Bart Gordon (D-TN), David McIntosh (R-IN), Pete Peterson (D-FL) and Earl Pomeroy (D-ND) said that a rush of high default schools into the direct loan program should be viewed as, what Rep. Pomeroy called, an "alarm bell", signaling caution toward the new program.

The Members released default rate data for more than 50 schools already in the Direct Loan program. The numbers show there is cause for alarm:
- Nearly all the schools had default rates of 25% or higher for the last two fiscal years.
- At least four schools have posted default rates of 25% or higher for three straight years.
- Six schools had default rates of 40% or higher for one year, including:

Institution Name	State	1992 Default Rate
Las Vegas Gaming School	NV	47%
California Nannie College	CA	45%
Natural Motion Institute of Hair	NJ	41%
Elegance International, Inc	CA	41%

"I believe there is enough old-fashioned common sense in this body to say 'no' to this kind of policymaking," said Rep. David McIntosh, "Unlike the person who approves these schools over in the Department, we face real students, real schools, and real taxpayers."

"What this means is there are schools where the education and job placement opportunities are so poor that nearly half their students are forced to default on their loans," said Congressman Gordon. "This is simply unacceptable for ANY loan program, public or private."

In addition the Members presented newly uncovered information that shows how inefficient the Department of Education has been in purging high-default schools from the student loan system.

A survey of 27 of the nation's student loan guarantors found 400 schools who have appealed their removal from the student loan program because of high default-rates. By law, the Department of Education has to process these appeals within 45 days. Yet, despite the fact that all of these appeals are at least six months old, only 4 of those 400 have been processed. Thus, over 99% of the schools who had appealed their removal from the system still receive taxpayer-backed loans for their students, continue to default on those loans and are continuing to sign up for direct lending.

"The Department of Education is not addressing the problem of high default schools in the guaranteed loan program," said Rep. Pete Peterson, "but there is no reason to allow these same schools into direct lending where no default rates will be calculated."

The Members also cited a recent letter by the Advisory Committee on Student Financial Assistance, which was critical of the Direct Loan program. The Committee, a non-partisan group authorized to review the Department of Education's student loan program, took the Department to task for having no institutional quality control and allowing hundreds of high-default rate schools free access to tax-payer financed loans.

Specifically, the Committee found that the list of 1995-96 direct lending participants includes:

-272 schools with default rates of 25% or higher in at least one of the three previous years

-160 schools with default rates of 25% or higher in the most recent fiscal year

- 100 schools whose default rate data were either 'missing or potentially unreliable'.

"Before I came to Congress, I spent eight years trying to make sure insurance companies remained solvent," said Rep. Earl Pomeroy. " I learned then that no company can produce business as fast as we're seeing with direct lending, unless they cut corners and accept bad risk -- sacrificing short term gain for long term pain. Unfortunately, that's what the Department of Education is doing to the U.S. Treasury," Pomeroy said.

Government studies have consistently shown that student loan defaults are concentrated among proprietary schools. Of the 1,420 schools accepted to participate in direct lending during the 1995-96 academic year, 728 (51%) are proprietary schools. According to the Department, only 24 percent of all four year institutions are participating in direct lending.

"This information confirms my worst fears about direct lending," said Rep. Bart Gordon. "With a number of other Members, I have worked hard to ensure that high-default schools are prohibited from participating in the guaranteed student loan program. Many of these high-default schools are simply scam operations that saddle their students with taxpayer-guaranteed debt and provide little or no educational or career benefit. We have put safe-guards in the student loan system that have saved the taxpayers over $1 billion every year. Now these same schools are flocking to the Direct Lending Program where they don't have to worry about default rates."

"We know the direct loan program means hundreds more bureaucrats at the Department of Education," said Rep. David McIntosh, "it adds as much as $165 billion to the national debt, and in the end, no better deal for students."

"These examples clearly show that the Department of Education is moving too fast on this agenda," said Rep. Bart Gordon. "The Department of Education does not have that ability to manage this program and should not be moving toward full implementation."

The Members present today are all supporters of the Goodling-Gordon Bill, HR 530, which would slow the implementation of the Federal Direct Loan Program (FDLP) to allow a thorough evaluation of the program and require the FDLP to include default restrictions similar to the guaranteed student loan program.

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Default-rate Limbo

400 schools have been waiting for more than six months for the Department of Education to resolve their FY 1992 cohort default rate appeals.*

Number of Schools Appealing Their FY 1992 Cohort Default Rates	Number of Recalculated FY 1992 Cohort Default Rates
400+	**4**

*1995 industry survey of student loan guarantors

Outrageous Default Rates

Key examples:	FY 1992
Las Vegas Gaming and Technical School Las Vegas, NV	47.1%
California Nannie College Sacramento, CA	45.2%
Natural Motion Institute of Hair Design Jersey City, NJ	41.3%
Elegance International, Inc. Los Angeles, CA	41.0%

Threepeats

Schools that have posted default rates >25% for three straight years

Key examples:	FY 1990	FY 1991	FY 1992
New World College **Anniston, AL**	32.6	35.8	45.3
Catherine College **Panorama City, CA**	26.6	26.4	32.3
Asher Business **Norcross, GA**	29.9	26.9	25.4

Higher Education Act of 1965

Sec. 435 (a) (2) Ineligibility based on high default rates

- "The Secretary shall issue a decision on any such appeal within 45 days after its submission."

▶ **"Therefore, the Secretary will continue to select schools for the Direct Loan Program that also meet the stricter default rate requirements adopted for that program for the 1994 - 1995 academic year. Consequently, in order for a school to participate in the 1995 - 1996 academic year, the school must also have a cohort default rate of less than 25 percent in one of the two most recent fiscal years...."**

- Federal Register
February 17, 1994

Two-Time Losers

59 Institutions have default rates of 25 percent for last two fiscal years*

Key examples:	FY 1991	FY 1992
Connecticut Business Institute Stratford, CT	30.1	34.8
Tidewater Technology Virginia Beach, VA	37.0	31.4
TAD Technology Kansas City, MO	30.6	33.1

*Advisory Committee on Student Financial Assistance

- "ED's Selection Process allows institutions with questionable records to participate in the FDLP for 1995-96"
  RESULT: 272 schools have default rates of 25 percent or higher in FY 90, 91 or 92

- "There appears to be no plan to monitor institutional quality to detect mismanagement by high default institutions"
  RESULT: Direct loan schools have "new opportunities for mismanagement..."

- "ED has not developed measures of institutional quality required to ensure program integrity, comparable to the cohort default rate in the FFELP"
  RESULT: High default schools have found a home in the direct loan program

- Advisory Committee on Student Financial Assistance, March 17, 1995

Year 2 Schools*

Kind of school	Number	Percentage
4-year public	231	16.3
4-year private	238	16.8
2-year public	160	11.3
2-year private	63	4.4
Proprietary	728	51.3
Total	1,420	100.1**

*Source: General Accounting Office
**Does not total 100 percent because of rounding

Advisory Committee on Student Financial Assistance

March 17, 1995

The Honorable James M. Jeffords
Committee on Labor and Human Resources
United States Senate
513 Senate Hart Office Building
Washington, D.C. 20510

Dear Senator Jeffords:

Thank you for the opportunity to provide observations and suggestions regarding integrity in the Ford Federal Direct Loan Program (FDLP). As you know, our Committee has been evaluating the implementation of the FDLP in accordance with a mandate from Congress. Our study, now in its second year, includes the Federal Family Education Loan Program (FFELP) as well, and will produce a second report this summer on all aspects of program implementation.

The program integrity issues discussed in your letter are important ones that have two key dimensions: program accountability and institutional quality. With regard to program accountability, the problems encountered in FDLP reconciliation in the first year are a symptom of broader challenges facing all Title IV programs. With regard to institutional quality, the lack of appropriate measures--specifically an equivalent to the cohort default rate currently used in the FFELP--signals a need for a much closer look at how quality can be ensured in the new program. In both areas, the problems can be addressed by proper corrective actions by Department of Education (ED) managers in charge of student aid delivery and the FDLP.

The remainder of this letter discusses the issues of program accountability and institutional quality raised in your letter by identifying the underlying causes of the problems and making recommendations to remedy them. In order to establish the context in which our findings are presented, several caveats are in order.

- The Advisory Committee's study to-date has found the FDLP to be a feasible loan program with important, desirable features for institutions and students. These include integrated delivery, institutional origination, and income contingent repayment.
- Implementation of the program has progressed well and program operation has been quite smooth through loan origination and disbursement.

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An independent committee created by Congress to advise on student aid policy

- ED has shown clearly that it has the ability and commitment to manage the FDLP effectively.

However, even though the FDLP has been shown thus far to be feasible, desirable to institutions and students in its operation, and manageable by ED, your letter is correct in its assumption that important shortcomings do exist that will threaten accountability and quality if not addressed in a timely manner.

PROGRAM ACCOUNTABILITY

The Committee has identified problems in the FDLP reconciliation process, which is designed to ensure that the loan records and the cash management data in the FDLP servicer and the institutional systems match precisely. Similar problems have been observed by ED's Office of Inspector General (OIG) and are reflected in ED's Dear Colleague Letter concerning reconciliation. Our Committee believes that there are four causes of the problems.

- *Structural deficiencies* in the overall delivery system for student aid adversely affect all Title IV programs--including FDLP loans. These deficiencies were highlighted most succinctly in a letter from our Committee to Secretary Riley on June 15, 1994.

- *Short-run policy decisions* by ED managers, necessitated by these structural deficiencies, have exposed the program not only to inefficiency but potential program integrity problems. The Advisory Committee addressed these issues in both our August 1994 report to Congress on the loan programs and in a letter to Congressman Goodling on October 31, 1994.

- *Software problems* have hampered program operations from the outset. The Advisory Committee was able to explore the scope of the problems with ED-supplied software with 18 institutions at its hearing in California last November.

- *Design shortcomings* in the FDLP servicer system have prevented smooth operation in *back-end* processes, including reconciliation. These problems were documented and discussed at the same hearing.

In order to fully appreciate the problems of reconciliation--and their solution--it is necessary to review the contribution of each of these factors.

First, *structural deficiencies* in the student aid delivery system result from the lack of a fully functional Title IV-wide recipient database that can integrate all program operations. The problems that result continue to haunt the Title IV programs, including the FDLP and the FFELP. For example, the current delivery system cannot identify where the student is enrolled, even after the award and disbursement of thousands of disbursements of funds to borrowers for as many as 60 days or more after the disbursements are made. While well-intentioned, this policy contributed greatly to delays in reporting and resulted in a significant gap between drawdown and reported disbursements, and complications in reconciliation.

The policy decision to allow institutions flexibility in reporting makes preventing multiple loans and tying drawdowns to disbursements impossible in a system without a fully functional, student-level database. Even if the FDLP servicer is directed to match loan records across institutions at the *back end*, a procedure not currently in place, ED's policy of permitting institutional flexibility in reporting makes it impossible to identify multiple loans *before* disbursement occurs. Finally, although the Advisory Committee is not aware of first-year FDLP institutions taking improper advantage of this flexibility, such as maintaining excess cash, the processes currently in place are open to misuse because the origination, drawdown, and disbursement processes are not sufficiently integrated in spite of current Title IV cash management and FDLP regulations.

Third, ***software problems*** have compounded difficulties resulting from structural deficiencies and policy decisions by making the physical task of reconciling accounts much more difficult. Institutions have reported to the Advisory Committee that ED-supplied software is subject to slow data processing, systems crashes, and corrupted data. These problems have delayed or prevented schools from reconciling on schedule, an ability which is taken for granted in most large private data processing systems.

Fourth, ***design shortcomings*** in the FDLP servicer system have further intensified problems in conducting reconciliation. The most important of these is the loan-specific character of the FDLP servicer system, a shortcoming also reflected in ED-supplied institutional software. Institutions generally manage information on a student-specific basis. This design flaw increases dramatically the burden of performing even routine functions and the difficulty of conducting reconciliation successfully. In addition, other problems with system interfaces between the institution and the FDLP servicer have made the reconciliation process extremely tedious for institutions. Examples include rigid accounting protocols and mismatches between software and servicer edits.

All four factors--structural deficiencies in delivery, short-run policy decisions, software problems, and design shortcomings--have contributed to reconciliation delays and difficulties in the first year. In order to ensure program integrity in the future, ED must address each of these problems in a systematic manner. To ensure these problems are solved as soon as possible, the Committee is recommending that ED take several short- and long-term actions.

- Reverse previous policy decisions and modify the CPS to prevent multiple awards across programs and tie drawdown of funds to Title IV program disbursements, including disbursements of FDLP loans. This enhancement can be performed under the task order component of the new CPS contract. Conceivably, this new function could be installed in time for the 1997-1998 award year.

- Review the policy of allowing FDLP institutions wide latitude in reporting disbursements to the servicer, and move expeditiously toward more closely integrating origination, drawdown, disbursement, and reconciliation.

- Produce a reporting system that identifies quantitative targets for the second year of FDLP program operations and system performance that will allow real-time measurement of multiple awards, excess cash, and gaps between disbursement and reconciliation.

- Provide for an external evaluation of all ED-supplied institutional software used in the program and consider the need for a complete, parallel software redesign that can be installed in the third year of the FDLP program.

- Conduct an external systems review, including the database structure, aimed at eliminating design shortcomings such as the loan-specific nature of interfaces between institutions and the servicer. This should be completed in time for the third year of FDLP operations.

It is extremely important that the reconciliation problem not be viewed as a narrow, short-term problem. Once again, it is a manifestation of Title IV-wide systemic problems that must be addressed through a broad set of management corrective actions to ensure long-run program integrity.

INSTITUTIONAL QUALITY

The second question in your letter relates to concerns over the lack of a measure of institutional quality in the FDLP equivalent to FFELP cohort default rate determinations and the long-term consequences for program integrity. In response to your request, the Advisory Committee has conducted a preliminary analysis that includes an examination of the default histories of FDLP institutions. Our analysis has identified four problems.

- The *selection process* for allowing institutions to participate in the FDLP appears to have permitted institutions with questionable performance records to enter the program.

- Current *selection criteria* appear to be inadequate to prevent problems related to program integrity in the future.

- There appears to be no plan to *monitor institutional quality* to detect mismanagement by high default institutions.

- ED has not developed *measures of institutional quality* required to ensure program integrity, comparable to the cohort default rate in the FFELP.

Each of these problems requires immediate attention to ensure institutional quality in the FDLP.

First, ED's *selection process* allows institutions with questionable records to participate in the FDLP for 1995-96. Exclusive of institutions eligible for cohort default waivers:

- 272 schools have default rates of 25 percent or higher in at least one of the three recent fiscal years for which ED data are available (i.e., FY92, FY91, and FY90);

- 160 institutions have default rates of 25 percent or higher for the most recent fiscal year; and

- 59 institutions have defaults rates of 25 percent or higher in both of the two most recent fiscal years.

Furthermore, well over 100 institutions accepted for the second year, of which the vast majority were proprietary institutions, had default rate data that are missing or potentially unreliable for the previous three years.

Because these institutions with high default rates or potentially unreliable data represent less than two (2) percent of 1993 FFELP loan volume, they are not likely to have a major impact on future FDLP volume. Nonetheless, their participation could contribute in a disproportionate way to a perception that the program is failing to ensure institutional quality. Since ED has considerable flexibility under the law in choosing institutions that are "reasonably representative," it could have screened institutions more carefully to ensure quality.

Second, current *selection criteria*, as they have been applied for 1995-96, do not appear to be adequate to prevent entrance of even more high-default institutions. The Committee understands that waivers may be appropriate for certain schools serving largely disadvantaged student populations and that objections have been raised about creating criteria for the FDLP more stringent than for other loan programs. Nonetheless, the criteria as currently structured appear to invite problems in the long-run, especially because other selection factors related to administrative capability will be relaxed in future years. In light of OIG's and the General Accounting Office's (GAO's) concerns about ED's gatekeeping function, the current criteria must be examined very closely.

Third, there appears to be no plan to *monitor institutional quality*. The existence of an income contingent repayment option in the FDLP--an option that S.495, the "Student Loan Evaluation and Stabilization Act of 1995," would extend also to the FFELP--offers new opportunities for mismanagement by institutions of poor quality. While it is technically still possible to be delinquent, or in default, on an FDLP loan, institutions could use income contingency as a management tool to mask the consequences of poor educational programs. The Advisory Committee knows of no plan by ED that addresses this issue either at the application stage or through monitoring of institutional performance. Similar problems will emerge in the FFELP if income contingent repayment becomes available under that program.

Fourth, ED has not yet identified or analyzed alternative *measures of institutional quality* in the FDLP that will serve the same program integrity function as the default measure in the FFELP. Instead, there appears to be a widespread feeling on the part of ED management that default is, by definition, minimized under the FDLP, and consequently, that there is less need for such a measure.

In order to ensure program integrity, the Advisory Committee would urge ED to take corrective actions in each of these four areas:

- With regard to institutions already in the FDLP, ED should review its *selection process* and perform an analysis that identifies problem schools. As part of this process, ED should consider replacing these institutions with those having lower default histories[8]--especially with institutions that applied and were not selected for reasons other than quality.
- ED should develop new *selection criteria* designed to prevent the participation of institutions that are likely to have excessively high default rates or to misuse the income contingent repayment option.
- ED should formulate a system to *monitor institutional quality* that tracks and reports the use of the income contingent repayment option in the case of schools that are potential problems. This system must be able to detect unusual shifts in payment option selection as well as payment streams that signal likely program integrity problems. The system must also subject such institutions to intensive monitoring across other key indices.
- ED should carefully analyze and compare alternate *measures of institutional quality* that can be used to monitor and eliminate problem schools. These include delinquency and default rate in repayment options other than income contingent repayment, frequency of administrative assignment of delinquent and defaulted loans to income contingent repayment, and rate of selection and nonpayment in income contingent repayment. Other potential measures are withdrawal or dropout rates, program completion

rates, and success of graduates obtaining employment or meeting their educational objective.

In summary, the participation of institutions with high default rates, the absence of appropriate measures of quality equivalent to cohort default rates, and the failure to monitor institutional performance in light of these measures will have a predictable negative impact on program integrity in the FDLP. It is important that ED move aggressively in each of these areas.

As part of its continuing evaluation of the loan programs, the Advisory Committee will explore over the next few weeks measures that might be used as alternatives to cohort default rates. This will be a focus of the Advisory Committee's hearing in April. The Committee will make these analyses available to the Congress as soon as they are completed.

In the meantime, on behalf of each of our members, I would encourage you to consider the recommendations outlined above as a preliminary framework for your oversight hearings. Thank you for the opportunity to provide these recommendations. Please let us know if we can be of further help in this matter.

Sincerely,

Lynn M. Fawthrop
Lynn M. Fawthrop
Chairperson

cc: The Honorable Nancy Landon Kassebaum (identical original sent)
Advisory Committee members
Members of the Committee on Labor and Human Resources
Members of the Committee on Economic and Educational Opportunities
The Honorable Richard W. Riley
The Honorable Madeleine M. Kunin
The Honorable Marshall S. Smith
The Honorable David A. Longanecker
Mr. Leo Kornfeld

Advisory Committee on Student Financial Assistance

March 17, 1995

We thought it might be helpful to receive a copy of the enclosed documents which were produced by the Advisory Committee and referenced in the letter. They are as follows:

- June 15, 1994, letter to Secretary Richard W. Riley
- Implementation of the Federal Direct Student Loan Program and Modifications to the Federal Family Education Loan Program: A Report to the Congress of the United States and the Secretary of Education, August 1994
- October 31, 1994, letter to Congressman William F. Goodling

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An independent committee created by Congress to advise on student aid policy

Advisory Committee on Student Financial Assistance

October 31, 1994

The Honorable William F. Goodling
Committee on Education and Labor
U.S. House of Representatives
2263 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Goodling:

Thank you for reading and responding to our August report on the student loan programs. We are very happy the report was informative and beneficial to your oversight of the implementation of the Federal Direct Student Loan Program (FDSLP).

In your letter you asked for our Committee's reaction to four questions:

- Should the disbursement rules we recommended for the FDSLP also be used in the Federal Family Education Loan Program (FFELP)?
- Is the Committee satisfied that the Department is taking the necessary steps with respect to Title IV system design and potential integrity problems?
- What can the Department do in the short run while it redesigns its Title IV system?
- Does the Committee feel that the Department's use of Sallie Mae to ensure access to loans is adequate?

With regard to disbursement rules, your suggestion that if a rule is complex in FDSL it is also complex in FFEL is well taken. It certainly makes sense to evaluate such a change in FFEL. The rationale for our recommendations to the Secretary, delivered after legislative changes had been made, was that the Department had not implemented fully what Congress had made clear in statute–that disbursements in FDSL be consistent with Pell Grants. However, Congress made no such change in FFEL. Accordingly, our Committee made no recommendations about implementation to the Secretary in this regard.

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An independent committee created by Congress to advise on student aid policy

Advisory Committee on Student Financial Assistance

June 15, 1994

The Honorable Richard W. Riley
Secretary
U.S. Department of Education
400 Maryland Avenue, S.W.
Washington, D.C. 20202-0100

Dear Mr. Secretary:

I am writing on behalf of each of our members about a matter of great importance to the Department of Education (ED), the Congress, and the entire postsecondary education community. A singular opportunity exists to use upcoming procurements to restructure the systems that deliver Title IV student aid--to make them more efficient and ensure program integrity. The benefits to all parties are truly substantial and can be achieved without a significant increase in the costs of delivering federal funds to needy students. However, it appears that this opportunity may be squandered in a headlong rush to recompete existing contracts. We are recommending that you direct ED staff to carefully reconsider the long-run implications of their procurement strategy.

ED has issued draft requests for proposals (RFPs) for major contracts that support application, processing, and disbursement of Title IV funds. The structure of these RFPs will determine the capabilities and shortcomings of the student aid delivery system into the next century. Relatively modest modifications in these RFPs and resulting contracts can produce dramatic improvements in performance, efficiency, integrity, and cash management. Unfortunately, our initial assessment suggests that these systems will remain essentially unchanged for the rest of the decade.

In 1986, Congress charged the Advisory Committee to monitor delivery on an ongoing basis and make recommendations for improvement. We have just completed a year-long study of the systems and processes involved and have identified serious deficiencies. These were shared with ED staff in April of this year. A copy is enclosed.

Great progress has been made in the program and policy areas over the last few years. The vast majority of students now complete only one data set on only one form and are means tested under only one model. In contrast, the delivery system itself is a puzzling assortment of dozens of separate data bases, contractors and facilities, most of which do not communicate with each other. This, for example, forces institutions to report awards for the same student to several different entities at different times and on different schedules.

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it is too late to make the required changes, then we recommend extending contracts perhaps for one year--not rolling them over for five to seven years with unchanged specifications.

In the meantime, if the Committee staff can be of any assistance, please call our Staff Director, Brian Fitzgerald. Thank you for your attention to these important issues.

Sincerely,

Lynn M. Fawthrop

Lynn M. Fawthrop
Chairperson

Enclosure

cc: Advisory Committee members
The Honorable Madeleine Kunin
The Honorable Marshall Smith
The Honorable David Longanecker
Mr. Leo Kornfeld
Ms. Maureen McLaughlin
Mr. William Moran
The Honorable William Ford
The Honorable Pat Williams
The Honorable Thomas Sawyer
The Honorable Jolene Unsoeld
The Honorable Patsy Mink
The Honorable Robert Andrews
The Honorable John Reed
The Honorable Tim Roemer
The Honorable Dale Kildee
The Honorable Robert Scott
The Honorable Ron Klink
The Honorable Karan English
The Honorable Ted Strickland
The Honorable Xavier Becerra
The Honorable Gene Green
The Honorable Thomas Petri
The Honorable Steve Gunderson
The Honorable Randy Cunningham
The Honorable Dan Miller
The Honorable Paul Henry
The Honorable Marge Roukema
The Honorable Peter Hoekstra
The Honorable Howard McKeon
The Honorable Richard Armey
The Honorable Claiborne Pell
The Honorable Howard Metzenbaum
The Honorable Christopher Dodd
The Honorable Paul Simon
The Honorable Barbara Mikulski
The Honorable Jeff Bingaman
The Honorable Edward Kennedy
The Honorable Paul Wellstone
The Honorable Harris Wofford
The Honorable Tom Harkin
The Honorable James Jeffords
The Honorable Nancy Kassebaum
The Honorable Dan Coats
The Honorable Judd Gregg
The Honorable Strom Thurmond
The Honorable Orrin Hatch
The Honorable Dave Durenberger

STATEMENT OF THE NATIONAL ASSOCIATION OF STUDENT FINANCIAL AID ADMINISTRATORS

Dear Mr. Chairman:

As you and the members of your subcommittee begin hearings to consider whether or not there is a need to modify the existing statutes governing the Federal Family Education Loan Program (FFELP) and the William D. Ford Federal Direct Student Loan Program (FDSLP), I would like to take this opportunity to recommend for your careful consideration four principles, related to these two federal student loan programs, which our members believe should be maintained.

As you know, in August of 1993, the Congress enacted P.L. 103-66 which authorized the Secretary of Education to establish and administer a Federal Direct Student Loan Program. Fundamentally, this new program was designed to allow it to be phased-in over a five year period in hopes that it might prove to be a more cost effective and efficient delivery system for originating and collecting student loans than the Federal Family Education Loan Programs authorized under Part B of the Higher Education Act.

In its wisdom, the Congress carefully included in the statute transitional participation goals which were designed to insure there would be a manageable phase-in of the new direct loan program, and which insured that institutions would be afforded flexibility in deciding whether to participate. To date, the feedback we have received would suggest the William D. Ford Direct Student Loan Program has gone very well for the initial group of 102 institutions that participated during the 1994-95 academic year. With only a couple of exceptions here and there, all of these schools give the new program a solid endorsement and commend the Department of Education for its assistance and operation of the program. Likewise, feedback from the expanded groups of institutions that have signed-up to participate during the 1995-96 academic year is also very positive. Thus, it would appear that, so far, the new program is working well. We also have received feedback from members who have elected not to participate in the FDSLP, but who have decided to continue to operate under the Federal Family Education Loan Program. Many of these institutions have told us that service has improved under this program since the FDSLP began and that the competition has been positive. These schools are pleased with the FFELP and want it to continue as an alternative to the FDSLP.

Given this feedback from member institutions and the pending discussions and proposals regarding changing or limiting the two loan programs, NASFAA's Board of Directors adopted the following resolution at its May 2, 1995 meeting in Minneapolis, Minnesota.

RESOLUTION #1
PRINCIPLES WHICH SHOULD BE MAINTAINED IN THE FEDERAL STUDENT LOAN PROGRAMS

> There has been a great deal of debate in recent months regarding the Federal Direct Student Loan Program and the Federal Family Education Loan Program. In light of these discussions and pending legislative proposals, the Board of Directors of the National Association of Student Financial Aid Administrators hereby has adopted the following principles which should be maintained.
>
> 1. All eligible postsecondary institutions should continue to have the option, based upon the choice of each school, to participate in whole or in part in either the Federal Direct Student Loan Program (FDSLP)

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or the Federal Family Education Loan Program (FFELP).

2. The number of loans and percentage of loan dollars awarded under the FDSLP or FFELP should not be constrained by imposing limits or volume amounts on either program.

3. Individuals who borrow under either FDSLP or FFELP should be entitled to equivalent terms and benefits, including but not limited to, minimum and maximum annual and cumulative loan limits, interest and fee charges, and deferment and authorized repayment options.

4. In recognition of the effort and commitment put forth by the Department of Education, members of the lending community, and institutions, as a minimum the FDSLP and FFELP should be allowed to continue to operate as parallel programs until their current authorized time lines expire.

Adopted May 2, 1995 in Minneapolis, MN
by the NASFAA Board of Directors

If they are followed, we believe the principles contained in this resolution provide a responsible course of action which will insure that sufficient time has passed to enable Congress to make an informed decision regarding the future direction of the federal loan programs during the next reauthorization of the Higher Education Act, and will insure a period of needed stability for everyone involved in the loan programs.

We thank the subcommittee for considering these principles, and would be happy to provide any further assistance which would benefit the subcommittee's work.

CRS
Economics Division
Congressional Research Service • The Library of Congress • Washington, D.C. 20540-7430

Memorandum April 20, 1995

TO: Honorable Bart Gordon
Attention: Lisa Fox

FROM: Barbara Miles
Specialist in Financial Institutions

and

Dennis Zimmerman
Specialist in Public Finance

SUBJECT: Critique of the Administration's estimated savings from direct lending for student loans

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This memorandum is written in response to your request for an explanation of the Administration's claims of budget savings for the direct lending program for post-secondary education. The discussion is divided into three parts. First, the aggregate budget savings claims are examined. Second, the more precise 'subsidy rate' comparisons are discussed. Finally, we return to the fundamental economics of the issue: when direct and guaranteed loans go to the same students for the same purposes with the same terms, the Government's costs and benefits do not differ. Claims of savings for one form of loan over another are purely artifacts of budget scorekeeping.

Aggregate Budget 'Savings'

The Administration claims $12 billion of budget 'savings associated with the President's policy' on post-secondary loans for students over fiscal years 1996 through 2000.[1] The President's policy is generally understood to mean moving from using guaranteed loans made by commercial lenders to direct Federal lending. The quoted savings, however, include all those stemming from the 1993 Student Loan Reform Act (SLRA), including those achieved in the guarantee program (FFEL). The $12 billion savings estimate, in other words, should not be thought of as owing entirely to the shift to direct loans.

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[1] Office of the Undersecretary of the Department of Education. *Direct Loan/FFEL Program Cost Update*, February 1995.

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Logically, however, if the reforms instituted by SLRA were successful in removing more-than-competitive returns to lenders, any available savings should arise regardless of whether the loans are guaranteed commercial or direct Federal loans. Why? The post-SLRA guaranteed loans are not distinguishable in the marketplace from direct loans. The loans go to the same students with the same risk profiles, and carry the same interest rates and terms. This implies that the loans would bring the same price in the secondary market, which means that they have the same value and cost to society, regardless of their origins.[2] It is, therefore, arbitrary to attribute all the reform savings to either guaranteed or direct lending.[3]

Subsidy Rate Comparisons

A better way to compare the costs of direct and guaranteed loans is to ignore the aggregate savings estimates and focus on subsidy rates for the two types of loans, both calculated on the post-SLRA program rules. "Subsidy rates" represent the Government's cost of providing credit per dollar of loan and must be accounted for in the budget under credit accounting rules. For student loans, this "subsidy rate" is the difference between two present value calculations, done separately for direct loans and guaranteed loans. For a guaranteed loan, the Government's expenditures consist of interest payments to commercial lenders (which include administrative costs and some risks absorbed by lenders) and default costs. From this amount is deducted the present value of the Government's stream of revenue associated with the loan — fee income and any net default recovery. For a direct loan, the Government's expenditures consist of the principal of the loan, the interest payments on the money it borrows to make the student loan, and all of the risks. From this is deducted the present value of the Government's revenue stream — repayment of the loan (principal plus interest). Each calculation is then divided by the loan dollar value to yield the subsidy rate.

The Department of Education (ED) has estimated subsidy rates for both types of loans, under current credit scoring rules. The subsidy rates for direct loans are calculated to be 7.34 percent for 1995-2000. (That is, for every $100 of loan principal, the Government's costs are $7.34.) For guaranteed loans the rate is 15.41 percent. Thus, direct loans appear to be less expensive by 8.07 percent of loan volume. This calculation, however, ignores the present value of all administrative costs for direct loans, while including these costs for guaranteed loans. While this is in accordance with the current budget scorekeeping rules given in the preceding paragraph, it is an unintended consequence of incomplete reform in the Credit Reform Act of 1990 and does not reflect economic reality. Administrative costs of direct loans are accounted for on a cash basis, which means that most of these costs occur beyond the (5-year) budget scorekeeping window. In effect, following this approach is akin to saying administrative costs for direct loans are dramatically lower than for guaranteed loans, even when they are equal. This undercounting of actual administrative costs has misled some to believe that there are savings available to fund other activities, such as tax cuts or deficit reduction.

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[2] This is not entirely true. Direct loans carry an income contingent repayment feature which allows students to pay less than the interest owed for a period of up to 25 years, adding the difference to the loan principal. At the end of 25 years, the debt may be completely forgiven by the Government. Regardless of what it is called by the Government, this is a default for any investor. A private investor purchasing such a loan would pay a lower price than for an otherwise comparable guaranteed loan. In effect, this implies that direct loans with the income contingent feature are more costly than guaranteed loans.

[3] If income contingency ultimately has the effect of increasing default rates, a neutral accounting would show increasing program costs for the President's direct lending policy.

Reformed budget rules (such as those proposed in H.R. 589, at Section 8 (a) (II) (iv)) would require identical treatment for administrative costs for direct and guaranteed loans. Accordingly, ED has reestimated the subsidy rates with administrative costs accounted for on the same basis. Their new estimates still purport to demonstrate that direct student loans are less expensive for the Government than guaranteed loans, but the differential favoring direct loans falls by more than half to 3.89 percent.

Economic Realities

Where is the 3.89 percent direct loan advantage coming from? Any cost differential logically reflects some combination of three real costs associated with the loans that are being missed by ED's calculations.

- Risks attached to these loans that are borne by the private sector are not counted when owned by the public sector; there is no reason to believe these risks disappear when the loans are moved from private investment portfolios into the Government's portfolio.[4]
- Administrative costs for direct loans are actually higher than the present value that ED estimates.
- Excess returns still exist in the student loan programs. By excess return we mean that the interest rate charged to students is more than would compensate the Government and any competitive lender for all of its costs. Since both guaranteed and direct loans have the same terms (interest rates to the students), then excess returns accruing to private lenders under the guarantee program (which are counted as program costs) would also be excess returns accruing to the

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[4] ED's claim that the cost differential is attributable to a lower Federal cost of funds fails to recognize an important distinction. The perception of lenders to the Government is that the likelihood of being repaid is not tied to the riskiness of the student loans being funded, while the perception of lenders to private institutions is that the likelihood of being repaid is tied to the riskiness of the student loans being funded. Thus, using the Government's "pure" borrowing costs understates the cost of allocating resources to post-secondary education.

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Government under direct loans (which are counted as receipts and reduced program costs).

In fact, ED's lower cost estimate for direct loans includes an obvious transfer of private profits onto the Government's books. Unsubsidized Stafford, PLUS, and consolidated direct loans are estimated to earn profits for the Government (based on pre-administrative cost adjustment data). Subsidized Stafford loans, by contrast, are costly for the Government whether made as guaranteed or direct loans. The adjusted 3.89 percent subsidy rate advantage for direct loans combines these programs. The fiscal year 1996 budget projects that the "profitable" loans will amount to *just* under half of loan volume.[6] It is possible, therefore, that the direct loan advantage could be reduced significantly were the "profitable" programs separated from the Stafford Subsidized loans. To the extent the Government's interest in furthering post-secondary education leads it to remove profits from the unsubsidized loans in the future, the budget gains currently attributed to direct lending from this source would disappear.

Conclusion

At this juncture, the mismatch between the original problem and the proposed solution is noteworthy. What started this search for reform of the loan program was exploding default rates and more-than-competitive returns for commercial lenders. The proposed solution — direct lending — is largely irrelevant as a means of reducing these costs. More-than-competitive returns were virtually eliminated by the SLRA and, if anything, direct loans may well increase default costs. The primary way in which direct lending could reduce costs (assuming interest rates are set at a competitive level) is if the Government should succeed in lowering administrative and servicing costs relative to the private sector's performance with guaranteed loans. In fact this is not expected, and ED is contracting these functions back out to the private sector. There may be a logical rationale for direct lending, but lower cost is not it.

Focusing on the details of the estimation procedure is useful, but the broader issue tends to be obscured by a narrow focus on budget scorekeeping. The fundamental issue is: What is appropriate for the Government to do? There are many approaches to this question. The economic approach holds that in this case the need is to repair the capital market failure for post-secondary education. This is accomplished with the guarantee against default, and direct lending by itself adds nothing.

If you have additional questions, contact Barbara Miles at 77804 or Dennis Zimmerman at 78473.

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[6] *Budget of the United States Government, Appendix, Fiscal Year 1996*. p. 401.

UNITED STATES DEPARTMENT OF EDUCATION
THE SECRETARY

APR 29 1995

April 26, 1995

Honorable Bart Gordon
House of Representatives
Washington, DC 20515

Dear Congressman Gordon:

Thank you for your letter requesting further information on the Department's implementation of the Federal Direct Loan Program. I have enclosed responses to each of your questions, as well as additional materials for your use.

I hope you find this information helpful. Please let me know if I can be of further assistance.

Yours sincerely,

Dick Riley
Richard W. Riley

Enclosures

600 INDEPENDENCE AVE. S.W. WASHINGTON, D.C. 20202-0100

Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation

DEPARTMENT OF EDUCATION
RESPONSES TO CONGRESSMAN GORDON'S QUESTIONNAIRE

1. **Is it true that defaulted direct loans are carried on the Department's books as "uncollected revenue" -- and counted as assets -- rather than being counted as outlays? If so, please explain the justification for this accounting practice. Is this treatment consistent with the requirements of the Credit Reform Act? What are the amounts of such loans now being carried on the Department's books, and what are the projections for such loans for each of the next ten years?**

It should first be stressed that, for budget scoring and cost estimation purposes, defaults are treated exactly the same way under Direct Loans as they are under FFEL. Defaults are assumed to cost at least as much under Direct Loans as under FFEL, and all default costs for both programs are fully reflected in Department cost estimates.

That said, the method of accounting for -- as opposed to projecting and budgeting for -- those costs does differ between the two programs. This difference -- which is consistent with generally accepted accounting principles and the requirements of the Credit Reform Act -- reflects the different roles the government plays under the two programs. Under FFEL, in which the government acts as loan guarantor, defaults represent outlays -- one-time payments by the Government on loan guarantees. Under Direct Loans, the government acts as lender. Funds are outlayed at the time loans are made, and the government -- like ALL lenders -- carries outstanding loans on its accounts as assets that will be repaid. Defaults in Direct Loans reflect non-repayments to the Government by borrowers, and so are considered to be nonperforming assets. As noted above, however, this accounting distinction has no effect on program cost or savings estimates, or cost comparisons between Direct Loans and FFEL.

The Department is carrying $813 million in outstanding Direct Loans from FY 1994 on its books. To date none of these loans have defaulted -- in fact, most have not entered repayment, since the first loan was made less than a year ago.

Projected Direct Loan default costs are shown on the following table. (The Department has not done estimates for years beyond FY 2000.) Default costs -- particularly in the early years of Direct Loans -- reflect changes in loan volume as well as default rates. Increases in loan volume default costs can occur even as default rates drop. The year-to-year increases shown in the table below are almost entirely a function of increased loan volume resulting from the phase-in of the Direct Loan program.

Default Costs by Fiscal Year
(In millions of dollars)

	1996	1997	1998	1999	2000
Direct Loans	77	199	402	682	1,026

2. **A. To what does the Department attribute the reduced costs of loan defaults that have occurred over the past two years? B. How many compliance reviews of institutions were performed during those two years by Department of Education personnel?**

A. Default costs have gone down over the past few years for two main reasons. First, fewer borrowers are going into default due to statutory provisions under which schools with consistently high default rates lose their eligibility to participate in the Federal student loan programs. Second, more money is being collected from those who do default through the aggressive use of wage garnishment, the offset of Federal income tax refunds, and other collection tools.

B. FY 1993 - 609 on-site reviews (with $326 million in liabilities assessed)
FY 1994 - 560 on-site reviews (with $355 million in liabilities assessed)

3. **How frequently does the Department plan to review institutions participating in direct lending? What criteria will be used?**

In order to provide full coverage of FDSLP schools, all Student Financial Assistance Programs (SFAP) employees will be familiar with this new program and incorporate oversight standards accordingly.

SFAP plans to review schools participating in the Federal Direct Student Loan Program (FDSLP) as often and in the same way as it reviews schools that participate in the other Title IV programs. Schools will be selected for on-site program review under our factor list (which will incorporate FDSLP criteria). SFAP reviewers then will examine compliance with the statutes and regulations for all Title IV programs at the school.

requires that an institution match its draw down records with the Servicing Center's records. The Servicing Center receives draw down information on the institutions directly from the Department's Payment Management System.

It is clear that the Direct Loan system has more safeguards to protect the integrity of the program and reduce Federal risk than any other student financial aid program administered by the Department.

5. **Have all schools participating in the first year of direct lending reconciled their accounts on schedule? If not, what has been the length of and reason for noncompliance?**

Because of the misinformation and confusion that has surrounded this issue, we have prepared a paper that describes reconciliation, reports the problems that we encountered this first year, and outlines the steps we have taken and are continuing to take to improve the reconciliation process. A copy of that paper is enclosed.

The fact that a school has had difficulty in reconciling in no way implies that there is any problem with cash management or any suggestion of program abuse. In fact, under Direct Loans, the Department has better, more timely data than exists for any other Title IV program and this improved availability of data allows us to exert better and more effective controls to prevent and control program abuse than has ever been possible in the past.

6. **Please list Department projections (dollar amounts) for annual loan defaults for the FDSLP and the FFELP for the next ten years. How are these default costs figured into the estimated costs of each program in the Department's budget calculations?**

Projected default costs are shown in the following table. (The Department has not done estimates for years beyond FY 2000.) As noted above, default costs -- particularly in the early years of Direct Loans -- reflect changes in loan volume as well as default rates. Increases in loan volume can increase default costs even as default rates drop. All default costs are fully reflected in all cost estimates for the two programs.

Default Costs by Fiscal Year
(In millions of dollars)

	1996	1997	1998	1999	2000
Direct Loans	77	199	402	682	1,026
FFEL	2,500	2,815	2,836	2,807	2,738

7. **Please list projected cohort default rates for cohorts entering repayment in the FDSLP and the FFELP for each of the next 10 years.**

Because we have tried to be as conservative as possible in developing Department cost estimates, we have assumed that FFEL and Direct Loans will have the same default rates. Projected rates are shown in the following table. (The Department has not done estimates for years beyond FY 2000.)

FFEL/Direct Loan Cohort Default Rates by Fiscal Year
(In percent)

1996	1997	1998	1999	2000
14.70	14.66	14.51	14.22	14.47

8. **What loan volume does the Department project will be covered by income contingent repayment plans over the next 25 years?**

Our current projections assume that approximately 17 percent of all Direct Loans -- including consolidations from FFEL -- will be repaid under income-contingent repayment (ICR). This would result in roughly $27.2 billion in loan volume under ICR over FY 1996-2000. Because of the volatility of loan volume projections, we have not developed estimates for years beyond FY 2000.

9. **How much does the Department expect to save by offering income contingent repayment in order to prevent loan defaults? How much of the projected savings is due to the carrying of loans to indigent borrowers in income sensitive repayment on the books as loans in good standing (assets)?**

Again, because we have tried to be as conservative as possible in developing Department cost estimates, we have assumed that FFEL and Direct Loans will have essentially the same default rates. As a result, the only savings currently associated with income-contingent repayment (ICR) involve FFEL borrowers who are already in default and choose to consolidate into Direct Loans to take advantage of ICR. We estimate that such consolidations will save approximately $671 million over FY 1996-2000. As we noted in our response to question 1, the accounting treatment of defaults under Direct Loans has no effect on how the costs associated with those defaults are reflected in Department estimates.

10. **What is the projected amount of income contingent loans that will be forgiven after 25 years, starting in 2021 and continuing for the following 10 years?**

These projections are shown in the following table.

Costs Associated with Loan Forgiveness under Income-Contingent Repayment
(In millions of dollars)

	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Direct Loans	13.8	20.7	23.6	25.2	26.9	28.5	30.3	32.1	34.1	36.1

11. **How does the Department plan to reduce loan defaults in the FDSLP? Why does the Department expect these steps to be better than FFELP default-reduction plans?**

One of the most exciting aspects of the Direct Loan Program is the fact that it provides the Department with the tools necessary to conduct an effective default prevention program. We are committed to reducing defaults not only to save the Government money but to protect borrowers from being subjected to the stringent penalties associated with defaulting on their student loans.

A small number of borrowers is capable of repaying and chooses not to do so, and the Department will continue to apply the most severe penalties possible against those borrowers. However, all of the recent studies on this topic show that the vast majority of borrowers default because they are unable as opposed to unwilling to repay their loans. Our goal is to ensure that borrowers are given every opportunity to repay their loans and avoid defaults, and the following Direct Loans features will allow us to achieve that objective:

1. The availability of a number of repayment plan options is key to ensuring that borrowers do not default. The Standard, Extended and Graduated plans provide most borrowers with repayment options that meet their needs. The Income Contingent Loan Repayment (ICR) plan ensures that borrowers who wish to can repay their loans based on their income.

2. The Department is in contact with borrowers early in the loan process and that contact continues throughout the life of the loan. Our Servicing Center first contacts the borrower when the first Direct Loan disbursement is made. Notifications go out after each disbursement and an annual statement is sent to the borrower summarizing the total amount of the loan, the interest rate and other relevant information about the loan. This annual statement is sent out over the life of the loan so that the borrower has up-to-date information on his or her loan status.

3. Comprehensive loan counseling is provided to borrowers both through their schools and directly. The Department prepares and distributes entrance and exit counseling materials for borrowers to ensure that they fully understand their

rights and responsibilities and to inform them about the loan repayment options available to them. Our Servicing Center's Borrower Services Staff is available to provide specific information to borrowers about all aspects of their loans including individual assistance in determining the best repayment plan to meet each borrower's financial and personal situation. The Borrower Services Staff is also knowledgeable about the issues surrounding deferments, forbearances, and loan consolidation. Borrowers can contact the Servicing Center by mail or by toll-free phone lines.

4. We provide borrowers with a single entity with which they have to communicate over the life of their loan. All of their Direct Loans are held together, which means that they never have to worry about whom they have to notify if they move, where to send payments or deferment forms, or whom to call if they have any questions or need help.

5. The Department will know immediately when a payment is late and can contact a borrower to find out what the problem is that caused it to be late. More importantly, we can offer borrowers other options for getting into a current and successful repayment situation.

6. Our single motivation is to get students to repay their loans and we will do whatever we can to ensure that they do.

Under the present structure of the FFEL program there is not a strong incentive for lenders to discourage defaults. As a result, it is possible for a lender to conform to all of the due diligence requirements and still fail to make enough of a substantive contact to discourage default.

In addition, lenders are reimbursed by the guarantee agency for defaults at 98 percent of the total amount of the loan. Lenders turn defaulted loans over to guarantee agencies. Guarantee agencies must perform "due diligence" again, without ever having to actually get in touch with a borrower, before they can submit a default claim to the Government and be reimbursed up to 98 percent of the amount of the claim they paid to the lender. After that, guarantee agencies are free to pursue collection of the defaulted loan and are able to keep 27 percent of all payments they receive.

The fact is that there is no motivation to prevent defaults in FFELP. On the contrary, defaults are virtually no risk to the lender and a revenue source for the guarantor.

12. How will the Department prevent institutions of higher education that would have been removed from federal student loan programs because of excessively high cohort default rates from remaining in the FDSLP?

In order to participate in Direct Loans, a school must be eligible to participate in FFELP.

Schools must maintain their eligibility for FFELP even after they begin participating in Direct Loans. Section 685.400 of the Direct Loan regulations that were published on December 1, 1994 provides that FFELP cohort default rates will be calculated and applied to Direct Loan schools up through the final full year of the school's participation in FFELP. For schools participating in 1994-95, we will be using the FY 92, FY 93, and FY 94 FFELP cohort default rates to determine a school's eligibility to continue to participate in Direct Loans. For example, if a school that is participating in Direct Loans in 1994-95 has FFELP cohort default rates that are 25 percent or higher for FY 92, FY 93, and FY 94, that school will lose its eligibility to participate in both FFELP and Direct Loans. Similarly, for the schools that are first participating in Direct Loans in 1995-96, we will be looking at their FFELP cohort default rates for FY 92 through FY 95. If, in any three consecutive years, the schools have cohort default rates of 25 percent or higher, the schools will lose their FFELP and Direct Loan eligibility.

Since FFELP cohort default rates are not issued until 2 years or longer after the fiscal year for which they are calculated (i.e., FY 1994 rates are issued in 1996, FY 1995 rates are issued in 1997, etc.) the earliest that any Direct Loan school will not be covered by the FFELP cohort default rate is 1996.

We are going to be publishing regulations by December 1, 1995, to set out the calculation of cohort default rates for Direct Loans and establish other performance measures that will be used to assess schools' capability, much the same way as FFELP cohort default rates are used.

13. How will the Department prevent the growth of loan default problems that occurred during the 1970s and 1980s from recurring, given that the Department has indicated it does not intend to calculate cohort default rates in the future?

See answers to 11 and 12.

14. I understand that proprietary institutions have applied in relatively great numbers to join FDSLP. Why is this occurring, and why is there a smaller relative representation of non-profit and public four-year institutions applying for the FDSLP?

Of the more than 3000 proprietary schools in one or more of the federal student loan programs, only about 750 are participating in Direct Loans in the 1995-96 academic year. This represents about 50 percent of all participating schools, but only about 15 percent of the loan volume anticipated for 1995-96. These statistics roughly approximate participation of proprietary institutions in other Title IV programs. In the FFEL program, for example, in Fiscal Year 1993 more than 45 percent of participating institutions were proprietary schools. It does not appear, therefore, that proprietary schools are disproportionately participating in Direct Lending.

15. **Do you believe that the elimination of default rate calculations in the FDSLP is attracting proprietary institutions or other schools that are doing a poor job of educating their students? If so, why? If not, why wouldn't such schools want to join the FDSLP?**

First, as described in the answers to questions 11 and 12, the Department is not eliminating default rates in the Direct Loan program. Second, only schools that meet the legislative criteria for eligibility for Title IV student financial assistance programs can participate in Direct Lending; there are no separate eligibility criteria for schools participating in Direct Loans. From our perspective, default rates have been an effective tool for eliminating schools that do "a poor job of educating their students." The Department is committed to the full implementation of the wide array of default management and program integrity tools created by the Congress. The focus and direction of the Department's efforts remain the pursuit of the highest possible standards of program and systemic integrity.

16. **How many institutions have been accepted into the FDSLP that have cohort default rates of 25 percent or higher in either of the past two cohort years?**

In total, there are 240 schools participating in Direct Loans that have cohort default rates of 25 percent or higher for one of the two most recent years for which default rates have been calculated.

17. **Do you expect to require any institutions to enter the FDSLP in order to guarantee a reasonable representation of schools, as authorized by Section 453 (b)(2)(B) of the Higher Education Act of 1965? If so, how many of which type?**

Under current law, which provides schools with an opportunity to choose to participate in Direct Loans, we would not require any school to join the Program. Under the President's plan, however, which is designed to maximize cost savings in student financial aid, we would require schools representing 80 percent of the student loan volume to participate in 1996-97 and all schools would be required to participate in 1997-98.

18. **Of the 520 new employees that the Department has indicated it plans to assign to the administration of the FDSLP, how many will be assigned to monitor the integrity of the system, especially the criteria outline in Title IV, Part H, Subpart 3 of the Higher Education Act of 1965?**

As indicated in Question 3, all SFAP employees will be familiar with the FDSLP. Persons filling the 488 central and regional office positions located in the Institutional Participation and Oversight Service (IPOS) have the gatekeeping and monitoring responsibilities with regard to the Title IV programs, including the FDSLP. Oversight of the eligibility and certification functions listed in Part H, Subpart 3 of the Higher Education Act of 1965 is the responsibility of 61 individuals. They determine institutional eligibility to participate and administrative responsibility and financial capability for certification and recertification; make determinations regarding provisional certification and posting of surety; and process requests for changes in ownership, and for additional branches and locations. Another 292 positions, most of which reside in the regional offices, are responsible for carrying out the on-site program review functions of participating institutions also mentioned in Part H, Subpart 3.

These 353 positions are functionally responsible for eligibility certification and on-site program reviews for all Title IV programs. Of the 314 Direct Loan positions in FY 95, 80 IPOS positions are charged to the Direct Loan account. This represents 25% of the total staff for these specific functions.

The current plans include an estimated 520 FTE ceiling. The Department will be reviewing this need in an ongoing fashion. It is anticipated that this number will be reduced upon further implementation of the program.

19. **What steps are being taken to ensure that the employees assigned to the FDSLP are aware of their responsibilities to enforce educational and financial standards?**

Within the IPOS, approximately 100 new institutional reviewers hired in the regional offices over the last year have participated in a comprehensive, multi-faceted training program to prepare them to carry out compliance reviews effectively and efficiently. All have received two weeks of training in orientation to the Student Financial Assistance Programs organization and functions and in the major legislative and regulatory requirements of the programs themselves; and two weeks of training on the specific skills needed to conduct program reviews.

All participated during the week of April 10-14 in a final training session to review and extend their knowledge in the most difficult review areas. In addition, the new reviewers have participated in two one-week externships at two different types of postsecondary institutions, to help them understand the administration of the programs at the school level. Each participated in two program reviews scheduled specifically as training reviews for them; and most have participated in several other program reviews as well, sometimes as members of the concentrated team reviews. Additionally, they have participated in regional-office initiated briefings and training sessions on specific topics. This comprehensive program has provided a thorough orientation and submersion in all the knowledge and skill areas needed to perform their jobs. An additional benefit of this training program is that it has ensured greater consistency among the regions in their methods of conducting and closing program reviews.

Awareness of responsibilities with regard to the FDSLP will also follow as a result of interaction among offices, updated policy and procedural guidance, a revised Program Review Guide, coordination with other enforcement organizations (such as OIG), and revised job evaluation agreements.

For the Client Account Managers (CAMs), we are taking a three-pronged approach to ensure that they are aware of the Department's educational and financial standards and that those standards are upheld.

Our staff has undergone a comprehensive training program so that they understand how the financial aid programs are supposed to operate. The Account Managers' training included the following:

- one week of general Title IV student aid training;
- one week of lectures from the Direct Loan Task Force and the servicer;
- one or two week externship with a Year One Direct Loan school [depending on the employee's Student Financial Assistance (SFA) knowledge];
- over a week's training from representatives from Year One schools, which covered the loan process from the school's perspective;
- one week of hands-on computer training from NCS on the Direct Loan software;
- two weeks of classroom training from the servicer; and,
- one week of internship with the servicer.

As part of their presentations, the trainers covered what is permissible and allowable. To that end, we are coordinating with other HQ components to ensure that problematic situations are appropriately handled, carefully balancing the Department's oversight and assistance responsibilities. We formed a task group comprising both the oversight and Direct Loan assistance staffs to establish uniform procedures covering how we will responsibly deal with compliance issues. Our CAM Procedures Guide (currently in draft) will communicate how instances of non-compliance should be handled. We are also coordinating with departmental policy and systems units to ensure that we are providing feedback on operations that could be improved.

We are also establishing an internal communications system to ensure that needed information is quickly and efficiently disseminated to all Direct Loan components and contractors via weekly conference calls, the SFA Bulletin Board, a Questions & Answer database tracking system, and regular mailings.

20. **Could you outline how the Office of the Inspector General will interact with the FDSLP and with the employees assigned to administer FDSLP? How many employees of the Inspector General's office will be assigned to monitoring of the FDSLP? What steps will the Inspector General's office take to ensure that waste and fraud do not increase? What steps have already been taken, and what has been their result?**

The Office of Inspector General (OIG) is established to function independently from the Department of Education in overseeing the effectiveness of departmental programs and operations. While maintaining its independence, the OIG plans to continue working closely with the Department by providing advice and assistance in the design and implementation of the FDSLP to help ensure effective program operations. Further, the OIG has identified the FDSLP as a high priority area in their recently-issued Strategic Plan and in their 1995-96 Integrated Work Plan. The enclosed copies of these documents provide details regarding specific areas the OIG will focus on in the coming months.

Because of the nature of their duties, OIG personnel are not assigned on a program-specific basis. Therefore, it is difficult to estimate the numbers of employees that will address FDSLP issues. In recent years, OIG has dedicated up to 70 percent of its available resources to student aid programs administered by the Department.

To date, OIG staff have participated as advisors in the FDSLP systems development to help ensure the existence of proper front end controls for the program. Staff have also reviewed FDSLP regulations prior to their issuance as final rules, and have performed pre-award audits of FDSLP contracts to ensure proper pricing of contract activities.

On March 17, 1995, the OIG issued the first financial statement audit of the FDSLP as required by the Chief Financial Officers (CFO) Act of 1990. This audit was conducted under contract by UKW, an independent CPA firm. The OIG monitored the progress of the audit, reviewed supporting work papers and performed other procedures to ensure compliance with the CFO Act. A copy of the audit is enclosed for your review.

VANDERBILT UNIVERSITY
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February 21, 1995

The Honorable Bart Gordon
U.S. House of Representatives
2201 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Gordon:

Two years ago I wrote to Secretary Riley (copy of May 21, 1993 letter is enclosed) expressing Vanderbilt's concern about the administration's proposal for direct lending of student loans. At that time, we unsuccessfully urged the administration to rely more heavily on your proposals for cost savings in the student loan program and to slow down the effort to force a rapid and total transition to an untested, unproven direct lending program.

Unfortunately, nothing has happened in the last two years either to alleviate our concern about direct lending or to diminish our confidence in the continued ability of the guaranteed student loan program to meet the needs of our students. Accordingly, we welcomed news of your bill to cap direct lending at 40 percent and prohibit the Department of Education from forcing participation.

As you know, Vanderbilt is among those universities that have elected not to participate in the direct lending program. We have developed cooperative and highly efficient relationships with a number of banks and have developed processes that make both the application procedure for students and the delivery of funds from lenders more than satisfactory, and we know that the system works. This, coupled with those of your cost saving proposals that were adopted in 1993, combine to support the view that direct lending should be capped and the experience and results measured before deciding whether to extend the program further.

I would also like to comment on two other proposals. One is the idea of eliminating the in-school interest exemption for student loans. This would be a difficult additional burden, especially for those students who are planning to attend graduate school. The predictable result will be that students need to borrow additional amounts to pay interest while they are in school, thus increasing their debt burden and the likely period of repayment.

We are concerned that for some students this increased debt burden would be sufficient to cause them to decide against graduate school, particularly in fields such as research and teaching, where the salary potential is limited. And yet, these are precisely the fields that are so critical to the ability of this country to continue to regenerate the intellectual strength that will preserve its competitiveness. We already, for example, are seeing statistics that show that for some corporations employing researchers a majority of those employed in recent years have been foreign nationals, reflecting the diminished availability of American citizens for these important jobs.

Lastly, I would like to comment in support of the President's proposal for a tuition deduction for the parents of students, as well as for the proposals from both parties that would allow access to retirement savings accounts for the payment of tuition. Both of these are well conceived and we believe would, over time, enhance the ability of students of average means to attend the university of their choice.

Thank you very much for your ongoing effort to increase access to college and university education, and at the same time take into account the interest of taxpayers. Students are the ones who will truly benefit from your advocacy, both now and in the years to come.

Sincerely,

Jeff Carr
Vice-Chancellor for University
Relations and General Counsel

JC/ap

Enclosure

cc: Chancellor Wyatt
Provost Burish
Mr. Mohning

VANDERBILT UNIVERSITY
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May 21, 1993

The Honorable Richard Riley
Secretary
U. S. Department of Education
400 Maryland Avenue, S.W.
Washington, D.C. 20202

Dear Secretary Riley,

I appreciated the opportunity last week to meet with Acting Assistant Secretary Maureen McLaughlin and Assistant Secretary Designate David Longanecker. We recognize the theoretical potential for savings in President Clinton's direct lending proposal.

While in Washington I also met with Congressman Bart Gordon, a member of our Tennessee delegation. Mr. Gordon concurs that the current student loan system is too costly, but has raised questions, which we share, about the direct lending proposal.

These meetings, together with further discussion with David Mohning, Vanderbilt's Director of Student Financial Aid, lead me to believe that there is substantial agreement in principle on the objectives of student loan reform. We all start from the premises that accessibility of funds and service to student borrowers are critically important criteria, and that savings in the current programs must be effected and in a way that does not disadvantage students. And, I believe that there is some agreement on the point that beginning a direct lending program on a limited basis will provide valuable instruction critically necessary for the evaluation of larger scale implementation. The pilot program approved by the Congress last year would offer that opportunity. Enough questions remain unanswered about the administration of a direct lending program that a pilot must be utilized.

Accordingly, I urge that consideration be given to modifying the Administration's proposal in a way that would respond to questions and concerns raised in the Congress and elsewhere such that full implementation of direct lending is presented as an objective for the future, with partial implementation along the lines of the pilot program approved by Congress last year being the first step. At the same time, cost savings of the kind being developed by Congressman Gordon could be enacted in the current student loan programs. This approach would allow both for the benefit of actual experience in designing the details of a more comprehensive direct lending program and provide for a transition and period of adjustment. And, of course, it would leave a workable option for an alternative to direct lending if the pilot program demonstrated unexpected or insurmountable problems.

Among our concerns about direct lending is whether the estimated savings and administrative expenses of a direct lending program have been accurately assessed. Conflicting estimates are being offered by private sources and even by sources within the federal government. A trial of the program through the pilot would help demonstrate the actual cost-effectiveness of direct lending. A related question is whether the federal government can administer a direct loan program as efficiently as can the private lenders presently involved with student loans. Finally, there remains great concern about creating new entitlements at a time when the national debt weighs so heavily in the public mind.

An equally compelling reason to assess the proposal through a pilot is the stake which post-secondary students have in any change which would so greatly affect them. We must insure that change does not unexpectedly and adversely affect the level and quality of loan service available to students. The experience to be gained through a pilot program embodying the Clinton proposals will demonstrate how direct lending can be administered most effectively and efficiently.

Pending larger scale implementation of direct lending, much could be done to reduce costs in the current system of federally guaranteed loans. Mr. Gordon is proposing several measures which are estimated to reduce annual costs by about 4.3 billion dollars. He advocates, for instance, reducing the interest rate subsidy to lenders from the 91-day Treasury bill rate plus 3.1 percent to T-Bill plus 2.6 percent. Further, he favors reducing the administrative cost allowance to loan guarantors from 1 percent to 0.5 percent. He also proposes that the risk of loan default be shared to a greater extent by loan guarantors and by Sallie Mae through a restructuring of the default reimbursement rates. Similar proposals have been endorsed by private lender groups who indicate a willingness to assume greater risk and responsibility in the present system.

We appreciate the potential which direct lending offers as part of President Clinton's deficit reduction program, but would caution against full implementation before a pilot can address the issues raised above. At the same time, however, reform of the current system is an interim goal which can contribute to the cost savings sought by all parties.

Your leadership on this issue is much respected by those of us in colleges and universities across the nation, and of greatest importance to the students whom we serve.

Sincerely,

Jeff Carr
Vice-Chancellor for University
Relations and General Counsel

cc: Chancellor Wyatt
Congressman Bart Gordon

Duke University
Durham
North Carolina 27708-0028

SENIOR VICE PRESIDENT
FOR PUBLIC AFFAIRS

[illegible] ALLEN BUILDING
BOX [illegible]
[illegible]

12 April 1995

The Honorable Bart Gordon
United States House of Representatives
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Congressman Gordon:

As President Keohane is away from the campus, your recent letter concerning direct lending has been referred to me. A number of the issues you raise about direct lending were addressed in testimony presented by Jim Belvin, the director of financial aid at Duke, before the Senate Sub-Committee on Education, Arts and Humanities a few weeks ago. I'm pleased to enclose a copy of Mr. Belvin's testimony.

Please know that we very much appreciate the leadership you and several of your colleagues in Congress are providing to ensure that students who need financial aid in order to college have ready access to it. I hope we can count as well on your support for preservation of the in-school interest subsidy and the campus-based aid programs, which we believe are important to maintaining the principle of access for young people to attend college, and for our society to benefit from their full participation as productive citizens in our democracy. These programs have served our nation well by ensuring that college attendance is not reserved only for the wealthy, and we believe both the in-school interest subsidy and campus-based aid programs represent an investment in the future productivity of our work force and in the quality of people's lives.

With best regards,

Cordially,

John F. Burness

enclosure

cc James A. Belvin, Jr
Nannerl O. Keohane

SENATE COMMITTEE

ON

EDUCATION, ARTS & HUMANITIES

MARCH 30, 1995

OVERSIGHT HEARINGS ON DIRECT LENDING

James A. Belvin, Jr.
Director of Financial Aid
Duke University

Good Morning--My name is Jim Belvin and I am the Director Of Financial Aid at Duke University in Durham, North Carolina. I have had the privilege of working with needy Duke students and their families for almost twenty years and an opportunity to examine financial aid from both a local and national perspective.

I am pleased to have the opportunity to participate in this committee's important discussion about the student loan programs on which students at Duke and around the country increasingly depend. The financial partnership of federal, state, institutional and private providers formed many years ago has made college attendance possible for millions of Americans during the last thirty years. Before directing my attention specifically to the issue of federal loans, I would like to take this opportunity to plug federal Title IV aid programs. Unlike many government programs, federal work, grant, and loan programs require matching funds, limit each participant's period of eligibility, and require monitored progress towards a specified goal. The result is a partnership that works. This partnership helps make possible the education of our leaders, improves quality of life for our people, and ultimately returns far more dollars to the federal treasury in the form of increased taxes generated by higher incomes of college graduates. A careful examination reveals that Title IV federal funds represent an exceptional investment for our security and result in a "bootstrap" program that makes an enormous difference in the lives of young people. That is the end of my plug.

Financial aid has changed a great deal during my years at Duke. I entered the

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aid business two years before Congress passed the Middle Income Assistance Act known during its rather brief tenure as MISSA. Federal support of higher education financial aid programs has changed drastically during the intervening years. When I entered the financial aid profession the watch words were "choice" and "access". Aid was intended to provide capable students with access to higher education and a choice of institutions. Congress and our colleges and universities shared a commitment that students should have the opportunity to attend the school that provided them with the opportunity to, as the Army now says in its ads, "Be all you can be." Duke University is one of a declining number of institutions that remain committed to the proposition that ability to pay should not be a barrier for capable students to enroll in the college of their choice. In this regard, Duke University admits students based on an assessment of their academic potential and ability to contribute to the educational experience of their fellow students and the university, regardless of their ability to pay our tuition and fees. Once our students are selected, Duke commits to meet 100 percent of their demonstrated financial need during the four years of their enrollment. This commitment is made in addition to, or perhaps in spite of, the fact that because our tuition rates represent only slightly more than one-half of the actual cost of attendance, we are effectively offering every enrolled student a scholarship equal to the difference between tuition and the real cost of that education which Duke provides from its endowment, gifts from alumni, foundations, and other sources, including alumni, who believe that today's young people should not be denied the opportunity to access a Duke education solely because they are not wealthy.

Duke University's continuing commitment to access based on academic rather than financial criteria is extraordinary for two reasons, one obvious and one not so obvious. The obvious reason is cost—more than a decade of decreases in real dollar federal support combines with the increasing price of the technology and personnel costs that drive higher education's expenses, to make financial aid our fastest growing institutional budget item--at a rate that vastly exceeds the rate of tuition increase over the same time period. The second, and less obvious, reason relates to a different kind of need-- Duke's ability to fill its class does not depend upon my office. Frankly, the University could eliminate my office and enroll a very bright class year after year, consisting entirely of students who could afford to pay full tuition. We could save our resources and invest them in improved faculty salaries, enhancements to technology that is vital to education and research, expansion of our library, etc. But enrolling a student body consisting exclusively of bright, well-to-do students is not our goal. Financial aid at Duke University serves one purpose—it makes it possible for students to consider the excellent academic programs we offer without reference to their families' financial circumstances. This commitment to economic diversity allows Duke to enroll a student body that is among the country's most academically talented and economically diverse. This economic diversity has helped create a social, geographical, and racial diversity that guarantees that the educational process to which our students are exposed continues both in and out of the classroom. It is an education that benefits all of our students—regardless of need—and may cost less than attendance at a leading public university.

During the 1995-96 academic year, Duke University will spend in excess of 21.5 million institutional grant dollars to support students who need financial aid. This represents an increase of 434 percent over the 4.95 million we spent in 1985-86. (Over that same time period our tuition increased by 236 percent.) Although we have made this substantial and continuing commitment to our students, loans from the federal government and other sources have become an increasingly important part of the aid program by which our students are supported. Duke students this year graduated with an average student loan debt of $11,000. While this is relatively small by some standards, loans represent an important component of our student aid program. Even with Duke's considerable investment in financial aid, our students depend on student loans to help afford attendance at our university. Moreover, Congress's recent expansion of the Parent Loan for Undergraduate Students or PLUS program and the creation of the Unsubsidized Student Loan program that is available to all students has made student loans important to all of our students, regardless of their need.

Duke University has watched the debate surrounding Direct Student Loans with great interest because we know that federal loan programs, when coupled with funds we can provide, make it possible for us to enroll students of all financial backgrounds. Thus, ours has not been a dispassionate interest. Instead it is a rather passionate interest. Without a steady, dependable, and timely flow of loan funds, we believe large numbers of our students would be denied the choice to continue their educations at our university.

We are long-time participants in FFEL loan programs, lending to Duke students through all of its various iterations: FISL, GSL, and now Stafford loans. Although we did not participate in the Federal Income Contingent Loan program, we did pioneer our own such program, now discontinued, in the mid-seventies. Likewise we created an unsubsidized institutional loan program, still in place, that is directed to middle-income students ineligible for subsidized Stafford Loans. I outline our efforts in this area simply to underline our commitment to student loan programs. We understand the critical nature of this important resource and have tried to be innovative in our thinking.

With the needs of our students in mind, we have very carefully considered the Direct Student Loan Program. Frankly, we were initially intrigued by its promise to offer much of what we believe our students need—easily accessible capital, streamlined application procedures, rapid application approval, etc. Although we considered applying to be a Year-One direct lending school, we decided not to do so for four reasons: concerns about the Department of Education's ability to manage such a program; concerns about the potential burdens that would be transfered to Duke University; a concern about increased liability; and perhaps most important, our general satisfaction with our current lending program. Please allow me to elaborate on each issue:

1) Our students depend on the timely and efficient processing of their loan applications. The Department's long-standing difficulty in meeting both deadlines and administrative commitments is such that we did not feel that Direct Lending would provide a timely and dependable vehicle for our students' needs. In this regard, my greatest concern was and is for the Department's long-term ability to support this program. While I understand that they have been successful in supporting a very limited number of schools, I worry that full implementation may reveal many of the administrative difficulties that have for so long plagued the Department's stewardship of Title IV programs. Simply put, there is too much at stake, in my judgement, to rely on the bureaucracy in the Department to implement a new multi-billion dollar program successfully when its track record has been such a problem. A more judicious, phased-in approach will enable us to test that capability without putting in potential jeopardy the futures of young people who need these funds to attend college. The fact that a large percentage of public and private schools have resisted the pressure to sign up for Direct Lending suggests, I believe, that this concern is widespread.

2) Although Duke University is, as I noted earlier, committed to need-blind admissions and to meeting 100% of each student's demonstrated need, there is but so much money available to support financial aid. Operating the Direct Lending

Program on campus would involve the addition of at least one new staff member. In a time when we are struggling to hold down tuition—our 4.9 percent tuition increase this year was the lowest in 25 years—increased operating costs would lead to increased pressures on tuition or reductions in financial aid. Neither option is acceptable.

3) Under our current processing system our liability is limited. Handling all loan processing on campus would significantly increase institutional liability.

4) The current FFELP Program is very supportive of our students. Our ability to "take our business elsewhere" and to use the competitive marketplace has provided us with a powerful tool, a tool that we have used to the advantage of our students. When our students have problems with their loans, our lenders are responsive and eager to be helpful. Private sector lenders have also been very responsive to our ideas.

Although Direct Lending is largely an untried concept, we welcome its entrance into the market place. The presence of Direct Lending has clearly improved the performance of the private sector. Frankly, I would submit that the continuing presence of private lenders struggling to retain their markets has been good for the Direct Loan program. The competition has certainly been good for both students and institutions. Administrative costs have been reduced and students have saved money. Examples abound and include SALLIE MAE's Great Rewards program, Nellie Mae's Pay Back program—and whatever else is currently on the drawing boards in the private sector, and, I am sure, the Department of Education.

COMMONLINE, the new product created jointly by USAGROUP and SALLIEMAE is, perhaps, the best example of the market responding to the needs of students and institutions. This innovative new approach to lending improves on Direct Lending by removing most of the administrative burden and expense from campuses without increasing institutional liability. Direct Lending, for example, would have required us to add at least one position in the aid office; COMMONLINE will allow us to eliminate at least one position. As one who participated in the development of COMMONLINE, I can tell you that it is an excellent example of the opportunity institutions have to influence the private sector. Duke has agreed to become a beta test site for COMMONLINE beginning this spring. Following our determination of a student's eligibility, all loan processing and the actual electronic transfer of funds to the borrower's student campus account will be handled exclusively through COMMONLINE. The savings that institutions realize through this "paperless" loan processing system will now be available to help reduce the cost pressure that drives the rate of tuition growth and to continue campus aid programs now jeopardized by increasing costs. It will also substantially reduce the time between the student's application and actual receipt of loan funds.

Advocates on each side of the student loan debate probably hope that their particular program will prevail---that the competition will be eliminated through Congressional fiat or Department of Education action. I take the position that it is far too early to determine which program is most effective. While I am a clear advocate of the long standing lending partnership between the public and private sectors because it has served students well, Direct Lending provides a fair test of how best to serve students' lending needs in the future. The key , of course, is to insure that the test is fair, that the playing field is level. The Congress's original decision in establishing a Direct Lending pilot program was wise and judicious. I ask that you sustain that original decision and allow the pilot program to proceed to its originally scheduled conclusion so the results can be fairly evaluated. Such an approach will best serve the needs of our country and the interests of our future leaders and their families.

I appreciate having had the opportunity to appear before you today and will be pleased to answer any questions you have.

ECKERD COLLEGE

P.O. Box 12560
St. Petersburg, FL 33733
813/864-8331

April 7, 1995

Honorable Bart Gordon
U.S. House of Representatives
2201 Rayburn Building
Washington, DC 20515-4206

Dear Congressman:

Your request for comments from financial aid practitioners concerning direct lending is greatly appreciated.

These comments are stated from the personal viewpoint of the director of financial aid. It is uncertain whether these comments represent the administration of our institution. Your three questions are answered below.

1. What is your position on direct lending and the reasons for your position?

There are a number of concerns in relation to direct lending. Some are noted below:

a. If 8000 educational institutions, or even 4000 educational institutions, were signed with direct lending, would the service to the educational institutions be satisfactory? More importantly, would the service to the many borrowers paying back their loans be satisfactory? One may wonder whether the Department of Education could keep each borrower's loans combined and not split among servicers, and whether all parties concerned could be adequately serviced.

b. If direct lending were the primary loan program, would the federal government in the long run provide unlimited funds for student loans to help our future students? One wonders, considering the high deficits the government is facing, whether a move might be made to limit funds. Limited loan funds would only mean additional deficits in future years from the lack of an educated populace.

c. Do all the repayment programs of direct lending help the borrower? One could wonder whether some actually are a disservice to the borrower.

ECKERD
COLLEGE

P.O. Box 12560
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2. How do you feel about mandatory participation in direct lending?

Schools should be given a choice, and an adequate pilot program with a sufficient track record should permit informed decisions.

3. Are you satisfied with the service your school and students receive under the Family Education Loan Program and how do you believe it could be improved?

I am basically satisfied with the service our school and students are receiving under the Federal Family Education Loan Program (FFELP), but do feel that some improvements could be made to enhance that service.

a. The borrowers need a longer standard payback period than the ten years for higher accumulated debts. Graduates in recent years have found the job market flat, and others have chosen careers for which the pay will always be minimal. A longer standard payback period would be a great benefit to our borrowers.

b. Repayment programs offering needed borrower flexibility should be the same for both direct lending and the FFELP. Furthermore, these repayment programs should be reviewed to insure that they do benefit the borrower in the long run.

c. All loans for one borrower should be required to be combined and treated as one. Even when the school is careful to keep the student with the same lender and guarantor, we find that the loan can still be split to two different servicing centers. Servicing in the borrowers payback stage is far more important than how fast a student can receive loan funds.

Again, we are particularly appreciative of your invitation to comment concerning direct lending. Thank you for your effort in reviewing all the comments that you receive.

Sincerely,

Margaret W. Morris

Margaret W. Morris
Director of Financial Aid

Pittsburg State University

Office of the President

1701 S. Broadway • Pittsburg, KS 66762-7546 • 316/235-4100 • FAX 316/232-7515

January 27, 1995

FEB 02 1995

Congressman William Goodling
230 Ford House O. B.
Washington, DC 20515

Congressman Bart Gordon
103 Cannon House O. B.
Washington, DC 20515

Dear Congressman Goodling and Congressman Gordon:

We understand that you are co-sponsors of legislation that will contain the following primary provisions.

1. Cap direct lending volume at 40 percent allowing schools that have already been selected to participate in the program but confining the experiment to those institutions while the program is tested.

2. Mandate the use of FAFSA as the sole application for all federal student aid programs, including FFELP.

3. Exercise oversight over government spending on direct lending to determine its actual costs and savings. Congress may also move to amend the Credit Reform Act to include all of the federal administrative costs associated with the program.

We caution you to go slow with this change to direct lending, because the Stafford Loan program is working well. We have an excellent contact system with graduates for repayment, and we are concerned that we will lose this counseling effort yet receive blame if default occurs. We appreciate your consideration of a very integral part of our financial aid program.

If you need further information, please let us know.

Sincerely,

Don Wilson

Donald W. Wilson
President

dja
cc: Senator Bob Dole
    Senator Nancy Kassebaum
    Congressman Sam Brownback
    Congresswoman Jan Meyers
    Congressman Pat Roberts
    Congressman Todd Tiahrt
    Mr. Ron Hopkins

BUTLER UNIVERSITY

Office of the President
4600 Sunset Avenue
Indianapolis, Indiana 46208
317/283-9900

January 19, 1995

JAN 26 1995

Congressman William Goodling
230 Ford House Office Building
Washington, D.C. 20515

Dear Congressman Goodling:

I thank you for your thoughtful approach to limiting the scope of the "experiment" currently under way with student financial aid programs. Like many of my colleagues, I have sincere reservations about the wisdom of a program that will simply increase the dependency of both state-supported and independent colleges on a federal bureaucracy that is already too intrusive.

It is hard to conceive of applying a term "Pilot Program" to something that already covers almost half of the relevant higher educational institutions of the nation. It is even more difficult to reconcile the expressed concern for the welfare of our students with the advent of "SPRE's." The confidence that the Department of Education will be a more efficient provider of services than the private sector involves a difficult leap of faith, which is made only more difficult by our respectful concern for the federal deficit which the Direct Lending program will surely exacerbate.

I wish you the very best of luck in your endeavor and express the sincere thanks of our university for your level-headed concern to bringing some meaning to the words, "Pilot Program." At the moment, one has to wonder if the pilots in this program are all space cadets!

Sincerely,

Geoff Bannister

Geoffrey Bannister

cc: Congressman Bart Gordon
Senator Dick Lugar

PURDUE UNIVERSITY

STEVEN C. BEERING
PRESIDENT

January 18, 1995

JAN 26 1995

Representative William Goodling
Attn: Ms. Sally Stroup
230 Ford House Office Building
Washington, DC 20515

Representative Bart Gordon
Attn: Mr. Harrison Wadsworth
103 Cannon House Office Building
Washington, DC 20515

Dear Congressmen Goodling and Gordon,

On behalf of Purdue University, I applaud your co-sponsorship of a bill to limit direct lending to forty percent of all volume.

Purdue University enrolls over 65,000 students, and Title IV program awards exceed $50 million annually. For many reasons we would prefer not to have to "staff up" to become a loan and collection agency. In the past, we have supported the use of a demonstration program to test the direct lending concept. We continue to favor the current public/private partnership arrangements.

Thank you very much for assuming leadership in this important area.

Sincerely,

1031 HOVDE HALL, ROOM 200 • WEST LAFAYETTE, IN 47907-1031 • (317) 494-9708

OKLAHOMA STATE REGENTS FOR HIGHER EDUCATION

State Capitol Complex
500 Education Building
Oklahoma City, Oklahoma
73105-4500

January 27, 1995

The Honorable Bart Gordon
United States House of Representatives
2201 Rayburn Office Building
Washington, D.C. 20515

FEB 02 1995

Dear Congressman Gordon:

Thank you very much for co-sponsoring the " Student Loan Evaluation and Stabilization Act" with Congressman Goodling. This legislation will enable Congress to make a genuine comparison of the Direct Loan Program and the Federal Family Education Loan Programs (FFELP).

The previous Congress made student loan policy decisions and considerations based on erroneous premises. Specifically, direct lending appeared to save money due to an anomaly in congressional budget scoring under the Credit Reform Act. Dr. Rudolph Penner, former Director of the Congressional Budget Office, has repeatedly denounced this particular budget rule as arbitrary and biased toward direct lending. In addition, Mr. Dennis Zimmerman and Ms. Barbara Miles, economists with the Congressional Research Service, have also raised questions about the alleged savings that were derived from the faulty assumptions.

The FFELP programs are an essential source of funding for students and parents. The FFLEP is a very successful program providing approximately $23 billion in loan funds each year to assist approximately 1.5 million students and parents finance higher education. Many positive changes have been made to the FFELP and, as a result of these changes, the programs are administered and funds are provided in a more efficient manner.

I am of the strong opinion that the FFELP program, utilizing private capital and promoting joint participation between private business and the Federal government, is a more efficient, more effective and less expensive method of providing funds to students and parents. I believe that the " Student Loan Evaluation and Stabilization Act" will provide Congress with the ability to make this determination and I wholeheartedly support its passage.

I appreciate the opportunity to provide this information. Please contact me if we can be of further assistance.

Sincerely,

Hans Brisch
Chancellor

UNIVERSITY OF HAWAII – WEST OAHU

April 4, 1995

Mr. Bart Gordon
Member of Congress
House of Representatives
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Mr. Gordon:

In reply to your letter of March 22, 1995, I agree that the scope of the federal direct lending program should be limited until it is thoroughly tested and evaluated over a period of time long enough to see the long-term effects on default rates and delivery of loan funds to students.

Attached is a copy of a letter I sent to the Secretary of Education and Hawaii's senators discouraging a bypass of the pilot project for the Direct Loan Program, and indicating my reasons for opposition to direct lending--the federal government's failure to provide clear information in a timely manner, increased administrative complexity and workload.

I am very satisfied with the service our school and students have been receiving under the Federal Family Education Loan Programs--mostly through the work of the Hawaii Education Loan Program Office (United Student Aid Funds). Checks are delivered promptly. And equally important, the Hawaii Office keeps us financial aid officers informed on a timely basis of proposed, pending and passed federal legislation that impact our operations--and are doing a much better job of it than the U.S. Office of Education.

Thus, I am opposed to mandatory participation in direct lending. I fear that a system that has already proven itself to be efficient and effective (our current guarantee agency) will be replaced by one that is still largely untested in the long run, to the detriment of our students. Furthermore, in my experience the federal government doesn't show a good track record of coordination, communication or foresight--all of which are essential for the management and administration of such an extensive program as mandatory direct lending.

Please share these comments with others who will work to support H.R. 530. Thank you.

Yours truly,

Cynthia L. Suzuki
Student Services Specialist

96-043 Ala Ike · Pearl City, Hawaii 96782
Telephone: (808) 456-5921 · Facsimile: (808)456-5009
An Equal Opportunity/Affirmative Action Institution

UNIVERSITY OF HAWAII – WEST OAHU

STUDENT SERVICES OFFICE

April 8, 1993

The Honorable Richard W. Riley
Secretary of Education
400 Maryland Avenue, SW
Room 4181
Washington, D.C. 20202

Dear Secretary Riley:

I have been informed by a reliable source that a move is on to bypass the pilot project for the Direct Loan Program. As a financial aid officer, I am writing to strongly discourage this action.

Pilot projects are essential for determining the potential problem areas which need to be addressed in the writing of regulations and procedures. The anticipation of these problems before they occur in the actual program is essential to administer the programs efficiently and effectively. In my years as a financial aid administrator, the introduction of new programs or new requirements for existing programs before all the ramifications of the new material were considered, forced the Department of Education to come up with "band-aid" solutions in a pinch, and required financial aid administrators to make-do by "second-guessing" the regulations the Department of Education would eventually write. This had the detrimental effects of creating more unnecessary work, and adding even more confusion and complexity to that which already run rampant in the financial aid community among aid administrators as well as their clientele.

Further consideration should also be given to the Direct Loan concept itself. I do not believe most educational institutions have the administrative capability (including expertise, workforce and resources) to perform the functions currently performed quite well by lending institutions and guarantee agencies.

Any loan program needs to be carefully administered to maintain its integrity and keep it solvent for perpetuity. In the last 18 years I've been a financial aid administrator, I haven't learned of a single financial aid operation that is not already overwhelmed with its current responsibilities to administer the aid programs as they are. The additional burden that would be imposed by a direct loan program would be devastating.

Furthermore, in these times of restricted budgets, I do not foresee institutions readily and substantially increasing their staff in the financial aid department to accommodate the additional workload. If existing financial aid staff is forced to spread itself even thinner to administer this new direct loan program,

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An Equal Opportunity/Affirmative Action Institution

EMORY UNIVERSITY
Office of Financial Aid

Boisfeuillet Jones Center
Atlanta, Georgia 30322
404/727-6039

5 April 1995

The Honorable Bart Gordon
Congress of the United States
House of Representatives
2201 Rayburn Building
Washington, DC 20515-4206

Dear Congressman Gordon:

I am responding to your letter of March 22, 1995 regarding the Federal Direct Loan Program. Thank you for taking the time to ask the opinion of the financial aid community. I trust the responses you receive will provide helpful information which will influence sound decisions by Congress, resulting in the best possible array of services and choices for students.

Position on Direct Lending

I am not opposed to direct lending as an option for those institutions which believe it enables them to provide the best alternative for its students. I have colleagues in direct lending schools who are pleased with what they have so far experienced. However, I count myself among many others who are concerned about the Department's ability to support the program as it expands, the long-term impact on availability of loan capital, and the effect of direct lending on borrower default rates (given the change in how loans will be serviced and collected).

I am opposed to 100% mandatory participation since it assumes that all of our students have similar needs (which they don't) and since it puts all of our "eggs" in one basket (that the basket is a federal one also adds to our vulnerability; we have much less influence on the federal government than we do on the private market).

One reason direct lending is not attractive to Emory is that we have many graduate and professional students who need to borrow more than the Stafford Loan limits allow ($18500). These students are currently able to borrow federal as well as private capital from a single source such as Nellie Mae, LawLoans, MedLoans, etc. If we were to force these students into direct lending, they would have two lenders to deal with for loan origination as well as repayment, which can become a debt management issue. In addition, private lenders might stop offering attractive private loans if their base of Stafford business is removed. Many students would find an Emory education unaffordable without access to this private capital.

Satisfaction with FFELP

Emory is starting its third year using a state/private equivalent to direct lending. Our state agency serves as a single source for a multitude of lenders. Loan origination, guarantee and disbursement activities are done electronically. I would stack our private model of loan processing up against any other process and believe it would compare favorably. Also, because of our low default rate, some lenders rebate the 1% origination fee to our students up front. For now, we still allow students to choose their own lender, so not all of our loans are handled electronically. With the advent of Common Lines (a new service being offered by SallieMae and USA Group), our process will embrace many more lenders, resulting in 90% of our volume being handled electronically. Thus, we can still give students a choice of lenders while streamlining the process.

If direct lending continues to run smoothly for large numbers of schools, and if lower fees to students become a reality, then Emory may want to offer direct lending as an option for students who do not foresee the need for private funds.

Improvements Needed to FFELP

We acknowledge that many of the new initiatives being offered by private lenders are a result of competition with direct lending. On behalf of our students, we are pleased to be the beneficiaries of the competition, and look forward to the improvements in both programs which will result.

Our dissatisfaction with FFELP comes not from the lending or guarantee communities, but from Congress and the Department of Education. The rules and regulations governing FFELP are barriers to effective administration of the program. At a minimum, FFELP and direct loan policies and regulations should be identical. In addition, some regulations (such as withholding disbursements from freshmen for 30 days to make sure they don't drop out) should be performance-based, and be applied only in institutional settings which have retention or default problems.

My Suggestions

Clean up the statute and regulations. Allow direct lending to expand at the will of interested schools (a cap is unnecessary). Continue to test and evaluate direct lending and FFELP in terms of repayment and servicing activities, not just up-front processing activities. Continue to talk with the aid community.

Thank you again for your interest in our opinions. Please feel free to call me at 404/727-0260 if you wish to discuss this topic with me further.

Sincerely,

Anne M. Sturtevant

Anne M. Sturtevant
Director

LIFE COLLEGE
1269 BARCLAY CIRCLE
MARIETTA, GEORGIA 30060

USA 404-424-0554
FAX 404 429-4339

March 27, 1995

The Honorable Bart Gordon
U.S. House of Representatives
Congress of the United States
2201 Rayburn Building
Washington, DC 20515-4206

Dear Honorable Gordon,

Thank you for your letter of March 22 concerning loan options for schools and students. In your letter you requested to hear the views of campus officials. Please accept the following as my personal response as the director of financial aid at a small private non-profit institution in Marietta, Georgia.

I believe direct lending is not the best, nor only option! There are several reasons for my position: 1) the continued assurances, without exception, of Congressional funding for the Department of Education to fully and appropriately manage such a large program; 2) the ability of the Department of Education to effectively deliver a "product" to the community in a timely fashion...(an example: As of the writing of this letter we are still waiting on Chapter 3 of The Federal Student Financial Aid Handbook for 1994-95 and yet we are 3/4 through the year, and we only just received Chapter 2 in February 1995); and 3) the ability to be provided the same customer service I currently receive.

Please understand my concern is not with the personnel at the Department of Education because they can only work with the tools provided. My concern is more with Congress being able to consistently and irrevocably provide the Department of Education with the resources necessary to make such a large program work, indefinitely. This is best understood with the example of calling a customer service number and having to leave a voice message (direct lending) as opposed to receiving a human voice saying "how may I help you" (FFELP lending).

Obviously, from my comments above, I don't believe mandatory participation in direct lending is appropriate. The satisfaction with the service my school currently receives under the Federal Family Education Loan Program is excellent. Lastly, I would like to thank you for the opportunity to be heard about an issue which needs further discussion and more importantly...significant testing.

Sincerely,

David M. Haygood

David M. Haygood
Director of Financial Aid

SCHOOL OF CHIROPRACTIC
SCHOOL OF UNDERGRADUATE STUDIES

TOCCOA FALLS COLLEGE
TOCCOA FALLS, GEORGIA 30598

Office of Financial Aid

PHONE:
706-886-6831

March 28, 1995

Rep. Bart Gordon
6th District, Tennessee
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Congressman Gordon,

Thank you for the letter that you sent to Ms. Eby regarding the direct lending legislation. It is refreshing to see legislators actively seeking the opinions of the people their work will most directly affect.

I agree with you and Rep. Goodling that Direct Lending needs to prove itself before being accelerated to 100% of the nation's lending volume. In your letter, you asked that we address our position on direct lending and the reasons for our position; our feelings about mandatory participation and our satisfaction with the current FFEL Program and how it can be improved.

My personal position is that any activity or program that can be done by the private sector should remain private. One of the facts that I have learned from history courses is that the larger a bureaucracy grows, the greater burden it becomes to the people. This is a personal concern and does not necessarily reflect the views of anyone else at Toccoa Falls College.

Toccoa Falls College is a smaller school (roughly 900 students) that relies on Federal programs to keep the price of higher education affordable for many of our students and their families. However, we are not able as an institution to implement the computer system needed to participate in direct lending, though we are anticipating having the ability by next year.

I am also concerned by reports that state the Department of Education is ill equipped to handle the task of managing the volume of work that direct lending will require. I refer specifically to a letter from the Coalition for Student Loan Reform dated June 7, 1993 which states "In the last two years alone, ten different reports by the federal government's own watchdog agencies have criticized the Department of Education's administrative abilities. No reports issued about the Department capabilities suggest that it can administer direct lending" (D. Cheever: 1875 Connecticut Ave, Suite 640, Washington D.C.). The frustration that our office has felt in dealing with the Department lends credence to this.

TOCCOA FALLS COLLEGE
TOCCOA FALLS, GEORGIA 30598

Office of Financial Aid

PHONE:
706-886-6831

I believe that mandatory participation is very similar to the conscription of sailors that was practiced by the British navy of old. However, I am also aware of "the golden rule: he who has the gold makes the rules". If direct lending is the only means possible to serve our students, then I will do what is necessary to help them.

At present, we are extremely pleased with the current FFEL Program. We are receiving disbursements within eight to ten days of the student completing a Stafford Loan application. In addition, we have always received excellent customer service and very prompt solutions to problems from the variety of lenders, guarantors, and services that we use. Unfortunately, the same can not always be said for the Department.

Thank you again for this chance to express my views. I hope that this letter provides you with the feedback you wanted. If you have any other questions, please feel free to call or write.

Sincerely

Mark A Gerl

Mark A Gerl
Student Loan Manager
Toccoa Falls College

Florida Tech

Student Financial Aid and Scholarships

April 3, 1995

Mr Bart Gordon
2201 Rayburn House
Office Building
Washington, DC 20515-4206

Dear Mr Gordon,

I have grave concerns regarding the proposal to fully implement an untested federal direct lending program as a replacement for the private sector based Federal Family Education Loan (FFEL) Program.

If you can recall, the Federally Insured Student Loan (FISL) program was fully implemented without a pilot program. It cost the government millions of dollars and led to many school failings and individual student tragedies. It was replaced with the private sector based FFEL program.

Everyone is currently talking about how easy it is to make loans and obtain funds through the direct loan program. But what happens when the student enters repayment and/or has problems with his/her deferment? Who will be there to respond to the students' inquiries and to assist them with these problems? Will the Department of Education's administrative budget expand to support these activities? Who is going to be responsible for the servicing and collections? Are schools going to be held liable for high default rates because servicing and collection activities have been contracted to the lowest bidder? Currently these responsibilities lie with the lenders and guarantee agencies. If a lender or guarantee agency is not responsive to the school and/or its students' needs, the school can encourage it students to use others. I am concerned that the elimination of competition will breed poor service and inefficiency.

The current FFEL student loan system is working well and I am a strong proponent of making it better. Many aspects of the current program could be modified.

Experience shows that the federal government is often quick to authorize programs but is less able to provide necessary funding to meet the needs of students and their families. The current funding levels for Pell Grant and campus-based aid programs (College Work Study, Perkins Loan, and Supplemental Grant) are clear examples of programs suffering from this problem.

Florida Institute of Technology

150 West University Boulevard, Melbourne, FL 32901-6988 ■ (407) 768-8000, ext. 8070 & Fax: (407) 724-2778
Toll Free 1-800-666-4348

It is only prudent to wait until the pilot project has been completed before beginning rapid expansion of direct loans and correspondingly eliminating the current loan programs. The ramifications of implementing such a concept without testing the program first should be carefully considered. It would be a tragedy to have history repeat itself.

Thank you for considering these comments.

Sincerely,

Mr. Leonard Gude
Director of Financial Aid & Scholarships

APR 0 8 1995

ST. PETERSBURG JUNIOR COLLEGE
OFFICE OF THE DIRECTOR
Scholarships and Student Financial Assistance
(813) 791-2443

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St. Petersburg, FL
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CANAL PARK EXTENSION
TARPON SPRINGS CENTER
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(813) 724-1415

CARILLON CENTER
100 Carillon Parkway
Suite 100
St. Petersburg, FL
(813) 573-1123

CLEARWATER CAMPUS
2465 Drew Street
Clearwater, FL
(813) 791-2400

DISTRICT OFFICE
6580 - 66th Street North
Pinellas Park, FL
(813) 341-3600

HEALTH EDUCATION CENTER
7200 - 66th Street North
Pinellas Park, FL
(813) 341-3600

SEMINOLE CAMPUS
(Planning under way)
9551 Ridge Road
Seminole, FL 34642
(813) 341-3600

SPJC ALLSTATE CENTER
3200 - 34th Street South
St. Petersburg, FL
(813) 341-4440

ST. PETERSBURG/GIBBS CAMPUS
6605 - 5th Avenue North
St. Petersburg, FL
(813) 341-3600

TARPON SPRINGS CENTER
600 Klosterman Road
Palm Harbor, FL
(813) 791-5750

March 30, 1995

The Honorable Bart Gordon
The House of Representatives
2201 Rayburn Bldg.
Washington, DC 20515-4206

Dear Congressman Gordon:

Thank you for your letter of March 22, 1995 in which you seek my opinion with regard to the Federal Direct Student Loan Program. Specifically, you ask for my thoughts on three items.

•1. **What is your position on direct lending and the reasons for your positions?**

At this period in time, I remain a staunch advocate of private sector lending. Having been in the financial aid profession for some 17 years, I can honestly say I haven't seen a federal government program work more efficiently or effectively than the one administered by the private sector. The competition that is fostered in the private sector and, in particular, in the various lending institutions and guarantee agencies, fosters the most efficient system possible. Indeed, this competition ensures that students and educational institutions receive the best of service humanly possible. Should I find that my students aren't being properly serviced by lender "X", I can certainly inform students of this and help them select another lender. After all this is what competition is all about. Under the Direct Lending Program we no longer have this competitive spirit.

While the Department of Education is throwing many millions of dollars at the program in the initial implementation stage, I would venture to say in just a few years down the road you will not have this type of support. Furthermore, what many people fail to realize is that the origination and disbursement side of the loan process is the easy side. Wait four or five years when the collection of these student loans will have to occur on a large scale. Please understand that everyone is in favor of saving money and enhancing service. However, to think that the federal government will do a better job than the private sector is, in my opinion, wishful thinking.

•2. How do you feel about mandatory participation in direct lending?

I am adamantly opposed to any mandatory participation in direct lending. The Federal Family Education Loan Program is a very successful program. To abandon a program that has been in existence for some 30 years and to mandate that institutions have to participate in a new, untried, untested loan system is ludicrous. We are here to serve students and their families and to take the necessary steps not to jeopardize the student's access to post secondary education because of a rush to implement a new loan system which, in my view, is too speculative. Let us thoroughly test and evaluate the direct lending program before we inadvertently wander down a road of no return.

I would be remiss if I didn't mention that the overwhelming majority of lenders who participate in the Federal Family Education Loan Program is as concerned about the educational opportunities and quality being afforded our students as any organization. So much publicity has been directed toward them as being "selfish "and money hungry." This has put them in a very defensive position. In my 17 years of experience, I can honestly tell you that lenders are very concerned about our students and do everything possible to assist them. Indeed, many of the staff who are employed by the lending institutions are former financial aid professionals. I see a lot of caring, concern, and compassion in the lending community. I do not see this when I deal with federal bureaucratic agencies.

•3. Are you satisfied with the service your school and students receive under the Family Education Loan Program and how do you believe it could be improved?

By and large I am very satisfied with the service our students receive under the Federal Family Education Loan Program from our lenders and our guarantee agencies. Once again through the competitive spirit, they have relentlessly worked to streamline, simplify, and automate the loan process. This is not to say that things couldn't be improved. Like any program of this magnitude, there is always room for improvement. For example, initiatives could be undertaken to further automate the funds delivery process. As you know, direct lending provides an administration allowance to the colleges. Many of these institutions have used the funds (or the promise there of) to enhance their computer systems for electronic fund transfer and other computer applications. Why are educational institutions that participate in the Federal Family Education Loan Program not seeing these same funds; which then in turn can be used to improve their computer applications and, subsequently, enhance their service to students?

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Congressman Gordon, I want to take this opportunity to thank you for taking the time to solicit the input of the financial aid community. Also, I thank you for co-sponsoring HR530. We in the financial aid community, as you in the Congress, are committed to enhancing educational opportunities for all our citizens. For over a quarter of a century, the Federal Family Education Loan Program has provided the opportunity for millions of our students to pursue an education. Let us not hastily abandon a program that works and works so very well.

Again, thank you for this opportunity to express my thoughts on direct lending.

Sincerely,

Ray Pranske, Director
Scholarships & Student Financial Assistance

RP/vm

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GLENDALE
COMMUNITY
COLLEGE
6000 W. OLIVE AVE.
GLENDALE, AZ 85302
(602) 435-3000

March 28, 1995

The Honorable Bart Gordon
2201 Rayburn House Office Building
Washington, DC 20515

Dear Representative Gordon:

Thank you very much for your letter of March 22. It is an honor to provide you with information as it relates to such a vital issue as continued availability of student financial aid. Specifically, I will provide you with information as it relates to me, my school, and my school district.

Glendale Community College is a school of about 18,000 total students. About 25% of the total student body receives federal student aid, these students make up about 35% of the total full-time equivalence. We are the second largest school in a 10 school community college district, which is one of the largest districts in the nation.

My position on direct lending is that it is a program with tremendous potential to provide high levels of service to students. I have held, from the beginning, that my staff could administer the program very well, and in a manner that would provide greater and more timely service to our students. Given that position, I am not in the program, because I have serious questions about the Department of Education's long term ability to operate such a program. I grew up in the Pacific Northwest, but my father was raised on a farm in Missouri, and I believe I inherited his show me gene.

I am impressed with the results of year one, but I am not surprised that the funds could be delivered to only 104 schools. I am very interested in year 2 results. Two of the smaller schools in our district are to begin the DL process in year 2. They will be our guinea pigs, so to speak.

I have deep concerns about the back end service issues, and the servicer having no vested interest in the collection process. My other significant concern is that with everything controlled in Washington, the loan programs are terribly sensitive to the winds of political change. This is true in the FFELP, but it is somewhat mitigated by the banks controlling the actual flow of funds. I fear that money will be saved in the future with subtle unpublished methods, like just slowing down the delivery of funds with initial allocations and submission of documents like the Pell Grant Program is today. Once there is no competition, what is to prevent ED from returning to its normal bureaucratic ways?

I fiercely oppose the mandatory participation in a still unproved program. I believe that it is imperative to have a long term evaluation before dismantling the current FFELP. This evaluation must include all aspects of the program, not just the delivery to the first 100 schools. The department has, in effect, a one-to-one ratio of DL workers to DL schools for year one. If that is not the long term ratio, the service level of year one is meaningless. I am also concerned that the Advisory Committee on Student Financial Assistance, which is charged with evaluating the program, is not representative of the wide variety of institutions that participate in the programs. The committee is almost exclusively comprised of people at four year schools east of the Mississippi. What about those of us who have a horrible time even getting a phone call answered in Washington, because we are a few time zones away? What about the different concerns of the community college where many of our students must transfer to schools who are in different loan programs? I think this committee needs more balance.

Having said that, I do have concerns about HR 530 limiting the number of schools who may choose to enter the program. The competition has been very good for the FFELP. I, however, would not like to see my options limited. I believe if schools are left to decide, there will still be a large number who remain in the existing program. Let us run the course laid out, and to the victor goes the spoils.

By and large I am satisfied with the service we receive from the FFELP. There are some areas that I find problematic. It should be a computer adjustment to move money from Subsidized to Unsubsidized. Currently, when a student has either decreased or increased eligibility for subsidized Stafford loan, we must cancel the portion that we want to reduce and submit a new application for the loan we want increased. If the student has submitted a promissory note to repay $2625, then a shift from sub to unsub or vice versa that does not change the net amount of the loan should be done with a simple notification of a change in eligibility. A huge step in the right direction is being made by Sallie Mae and United Student Aid Funds in creating a common electronic loan format. This type of cooperation is needed in developing common Electronic Funds Transfer format. I think we should also be able to move to a loan application process for FFELP that is similar to the DL program. Most of the advantages of DL are only because the FFELP loan program faces tighter regulation.

I hope that my comments are useful in your pursuit of program stability. I might add that I believe that it would be a

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tremendous mistake to eliminate the in-school interest subsidy entirely. Certainly there is some middle ground such as establishing an income ceiling for loan subsidy in addition to demonstrated need.

I will be serving the Western Association of Student Financial Aid Administrators (WASFAA) as the Chair of the Federal Relations Committee. If I may be of any assistance in that capacity or simply as a Director of Financial Aid, I am at your disposal. I would be happy to provide data on the impact of any proposed legislation to my students or any larger group if I am able.

Sincerely,

Theodore E. Malone
Director, Student Financial Aid

U·A·L·R
OFFICE OF STUDENT FINANCIAL SERVICES

April 7, 1995

APR 14 1995

The Honorable Bart Gordon
Congress of the United States
House of Representatives
2201 Rayburn Building
Washington, DC 2015-4206

Dear Congressman Gordon,

In efforts on behalf of the financial aid committee and the students utilizing the programs to obtain their education is so greatly appreciated.

On the particular issue of Direct Lending it is the position of the University of Arkansas at Little Rock to keep all options open, but currently wait for the opportunity to evaluate the Direct Loan Program. We must be sure the change would be of benefit to our students and institution. Factors influencing this approach include:

- a new administrator
- changes in procedures
- timing of materials for evaluation
- making sure our basic process is streamlined
- advice of current Direct Lending users familiar with UALR
- trust of student and parent that options will always be there

In regard to the mandatory participation the answer is a definite no. Aid Offices have little Control over rules and regulations we must monitor. To be given on option when and how loan processing which is the most vital and expanding facet of aid could be completed is just unacceptable. This is compounded by the fact we would be required to join a program with little to no testing and one that has serviced a small portion of the loan volume. In the last year DOE personnel may have been able to travel directly to a campus, but that is not likely if all eligible institutions had to participate. And, there would not be the competition to keep standards high.

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U·A·L·R

Office of Student Financial Services

The service UALR receives for the Family Education Loan Program is excellent. Our primary contact (95% of all time) is the Student Guarantee Loan Foundation of Arkansas not only do they strive for improvements in their specific processing, but they have been willing to evaluate our individual processes and school needs. With SLGFA we have most of advantages that Direct Lending would offer, but we also have a check and balance of our work. SLGFA has formed a task force for student loan reform where anyone can send ideas for review. (They sponsored post card for students regarding the loss of interest subsidy). The relationships built within our state is far reaching what those relationships with the DOE would be.

Sincerely,

Cari Wickliffe

Cari Wickliffe
Director of Student Financial Services

University of Arkansas at Little Rock • 2801 S. University • Little Rock, AR 72204-1099 • (501) 569-3130

HAWAII PACIFIC UNIVERSITY
"Holomua Me Ka Oiaio"

**DEAN OF ADMISSIONS,
REGISTRAR AND FINANCIAL AID**

*The Honorable Bart Gordon
Member of Congress
Congress of the United States
House of Representatives
2201 Rayburn Building
Washington, DC 20515-4206*

Dear Congressman Gordon:

Thank you for your recent letter concerning the debate in Congress over the future of federally supported student loan programs. We are grateful for the opportunity to present our views on this subject since it will have a direct impact on our students and the University.

The following comments are provided in response to your specific questions:

- *We support your "common sense" option limiting the scope of direct lending to 40 percent of loan volume as the program is thoroughly tested and evaluated. We support your suggestion about whether direct lending offers any real tax dollar savings. The University is also concerned about being forced to participate in direct lending before it is clear whether the program is viable in the long term. We agree that untested acceleration to 100 percent direct lending would be a mistake. More specifically, we are concerned about the additional cost in computer hardware and personnel that will be incurred by the institution to establish and run an untested, mandated program. We strongly support the current FFEL program and believe we should have the option of continuing to participate in this private-lender system.*

- *As stated above, we strongly oppose mandatory participation in direct lending.*

- *We are satisfied with the service the institution and our students receive under the FFEL Program and believe that significant improvements have already been made in processing loans, e.g., lower fees, variable interest rates, lower interest caps, single loan application, higher loan limits, etc. The University has a close working relationship with its lenders and guarantee agency which facilitates loan processing for our students. If we have problems, we deal directly with our lenders and guarantor to solve them quickly.*

Again, thank you for the opportunity to participate in this important debate. In supporting limited direct lending until thoroughly tested and evaluated, we believe we are following the best course for students, schools and taxpayers.

Sincerely,

W.J. Fleming

*Walter J. Fleming
Dean of Admissions, Registrar and Financial Aid*

NORTHWESTERN UNIVERSITY
REBECCA CROWN CENTER
EVANSTON, ILLINOIS 60208-1117

VICE PRESIDENT
FOR
INSTITUTIONAL RELATIONS

AREA CODE 708
TELEPHONE 491-7490

April 7, 1995

The Honorable Bart Gordon
U.S. House of Representatives
103 Cannon House Office Building
Washington, D.C. 20515-4206

Dear Congressman Gordon:

We appreciate the opportunity to respond to your letter of March 22 with regard to the Direct Student Loan Program. As a matter of disclosure, I have been a member of the Board of Directors of the Student Loan Marketing Association for twenty years and presently serve as the Chairman of its Operations Committee.

In response to the questions you raise in your letter, Northwestern has been opposed to the development of the Direct Student Loan Program from its inception. In general, based upon our experiences with prior government student loan programs, we thought the concept was poorly conceived. Specifically, we were opposed for the following reasons:

1. The complexity involved in servicing unsecured debt;
2. The necessity to expand federal debt significantly in order to fund the program;
3. The unreliability of cost estimates provided by CBO;
4. The prospect of having 9,500 educational institutions acting as lenders.

This latter fact has been given little attention by Congress, yet it may be the most important reason why the Direct Lending Program should be repealed. Of the 9,500 educational institutions in the country, there are probably no more than 500 that have the management capability to originate and monitor student loans.

With regard to mandatory participation, the above reasons apply. We also believe that financial institutions have provided a competitive atmosphere to develop new customer relationships through the guaranteed program. The direct lending program does not offer such an environment, and, certainly, mandatory participation would eliminate such prospects entirely.

In terms of your third question, we are satisfied with the service provided under the Family Education Loan Program and believe that many of the changes that have been made in the program over the last ten years cannot be easily captured by the Direct Loan Program. For example, servicing has improved dramatically under the FELP program because of the standards established by the Student Loan Marketing Association. Unfortunately, the federal government will find it difficult to secure third-party servicers that will be able to achieve desired standards of performance with regard to due diligence. The servicers that do exist operate on very slight margins, and several are near bankruptcy. The large money center banks and Sallie Mae know how to service student loans. The federal government does not. The concept of subcontracting servicing is more a wish than an actuality and will require substantial auditing and more funds than presently estimated.

Finally, we would hope that Congress would limit the expansion of the program and treat it as a pilot until the total loan package of processing, disbursement, servicing, and collection have been fully and successfully demonstrated.

Sincerely,

William Ihlanfeldt

WI/jnm

cc: Bill Goodling, Chairman
House Economic and Educational Opportunities Committee

GMI

April 4, 1995

Representative Bart Gordon
2201 Rayburn Building
Washington, DC 20515-4206

Dear Representative Gordon,

Thank you very much for your letter of March 22, 1995 requesting my views on the phase in of Direct Lending. It is heartening to hear that you are taking a careful look at the impact of eliminating F.F.E.L. Programs.

Clearly, the opinions on potential savings under Direct Lending vary, and all projections are based on subjective assumptions and biased theories. The political irony of the debate could be the basis of a good Art Buchwald article. It seems that the major goals of congress today are to reduce cost and reduce the role of the federal government. What should be done when cost reductions might be achieved by increasing the role of the federal government?

Ten years ago William Bennett championed Income Contingent Loans as a program to replace GSL's. The projections were encouraging, progressive, optimistic, but, ultimately, unrealistic. We are fortunate today that ICL's were prudently piloted and evaluated. Please do what you can to assure that Direct Lending is tested with equal prudence.

In closing, let me say that we can not simultaneously reduce government and take on direct lending. Doing so would be akin to curing a hangover with a shot of scotch. Keep up the good work!

Sincerely,

Mark Delorey

Mark Delorey
Director of Financial Aid

GMI Engineering & Management Institute
1700 West Third Avenue • Flint, Michigan 48504-4898

Saginaw Valley
State University

(517) 790-4000 · From Midland: (517) 695-5325
2250 Pierce Road · University Center, MI 48710

Scholarships & Student Financial Aid
(517) 790-4168

March 28, 1995

The Honorable Bart Gordon
Congress of the United States
House of Representatives
2201 Rayburn Building
Washington D.C. 20515-4206

Dear Representative Gordon:

Yesterday I received your letter dated March 22, 1995. I truly appreciate your request for my comments on H.R. 530. Earlier this month I sent an Electronic Mail message to my Congressman, Dave Camp indicating my support for H.R. 530. In addition to H.R.530, I also support the bill introduced by Representative Ernest Istook. As you know, the Istook bill would phase out the Direct Loan Program . While I support the Istook bill, and oppose the provisions advocated by the Clinton Administration to require 100 percent participation in Direct Lending by 1997-98, I feel that H.R. 530 truly does present the best *common sense* option to Direct Lending.

You have asked me to declare my position on Direct Lending. I would agree with House Speaker Newt Gingrich who said recently he was "personally, unalterably opposed to direct loans... They may look fine now because we're in the loaning phase, later you have the getting phase. The federal government which is incompetent at almost every direct service it provides will, in the end, do to direct loans what it has done to housing. You don't want to be around.... your successors are going to find it a nightmare". Attached is a copy of the personal position paper that I wrote on April 12, 1993 regarding Direct Lending and the National Service Program. My thoughts have changed very little since 1993 regarding Direct Lending. I truly believe that Direct Loans are *not* a good idea. Although many schools have praised the virtues of the program, we have not had the opportunity to see a true test of the system. I am absolutely positive that the United States Department of Education is not capable of collecting and servicing student loans in the repayment stage. The easiest part of student loans is the loan origination phase, the hard part is repayment. It is critical to the Clinton Administration that we abolish the existing FFELP programs before Direct Loans go into repayment. At the point of repayment, the nation will see the total fallacy of Direct Lending, so the acceleration of the Direct Loan

Program is imperative. It is also, I believe a Democratic Party priority to push Direct Lending prior to the election of a Republican President in 1996.

In your letter you also asked about whater I am satisfied with the service my students receive under the Federal Family Education Loan Program. I was never dissatisfied with the service that we received even prior to Direct Lending. However, since the emergence of Direct Lending, our FFELP service has been phenomenal.

You mentioned in your letter that campus officials are concerned about the negative consequences of speaking out on the matter. This is very accurate. We have been pressured by the President's Counsel in Lansing Michigan, and by others to adopt a Pro-Direct Lending position. Thankfully, our University President is a very strong and principled leader who will not be pressured easily, and I have a great deal of respect for him.

Good luck to you as you work on H.R. 530, you have my full support.

Sincerely,

William L. Healy
William L. Healy
Director of Scholarships
and Student Financial Aid

C: Dave Camp, Member of Congress

[illegible]:GORDON

PRESIDENT CLINTON'S NATIONAL SERVICE LOAN PROGRAM-ONE FINANCIAL AID DIRECTOR'S OPINION

by

William L. Healy

April 12, 1993

386

I. The proposed National Service Initiative is good for students and good for the nation.

A) The concept of delaying college attendance while performing public service is not new. The idea of earning some type of credit while serving in the military has been around in various forms for many years. In fact many legislators earned their college degree under one of the G.I. Bills.

B) Many recent high school graduates are not ready to enter college, and would benefit from the maturity gained through involvement in some type of national service plan.

1) The American Council on Education (ACE) has indicated opposition to the Voucher System of delayed entry because needy students might be forced to wait to enter college. The concerns of ACE are legitimate.

C) Giving of one's self to programs such as the Peace Corps, VISTA, or the military may not bring large amounts of remuneration, however the experience gained can be of great value. In addition to the services mentioned above, students should be encouraged to enter occupations which serve the public good such as police officers, fire-fighters, nurses, and teachers in teacher shortage areas.

D) Community service agencies, many of which may be funded by United Way types of organizations desperately need help. The services provided by pre-college students could be a lifesaver in more ways than one.

E) The concept of National Service might help pre-college students to realize that there are more important concepts in life than the pursuit of dollars. While most college students will focus on the performance of a vocation or career after college, we as a society must reinvest ourselves in our communities and neighborhoods. Hopefully this community reinvestment spirit will be come a lifelong habit for future college students.

II. IRS Collection of Loans. Under President Clinton's National Service Inititative two basic options for loan repayment would exist:

1. through one or two years of community service (capped at $20,000) loans could be canceled,

2. by making payments which would be based upon a small percentage of income. Under this potion payments would be due on April 15th of each year. Payments would be collected and monitored by the IRS.

A) While the IRS option sounds quite simple, it might be prudent to question the wisdom of moving an already privatized function under the operation of a federal bureaucracy.

   1) Under the current system schools have some degree of choice of servicers based upon the lenders a school chooses to recommend. If a lender or a servicer does not serve students well, the school can direct students to lenders or servicers who DO understand the concept of customer service. If we as schools do not like the service our students receive from the IRS, will we have a free market option to send students elsewhere?

      a) Will the IRS be motivated to offer good service when they enjoy a monopoly?

III. Direct Loan Program-not a good idea

A) Will add to the federal deficit-
1) Congress is finding it difficult to fully fund the Pell Grant Program. Secretary Riley has indicated that maximum Pell grants might have to be lowered from the already reduced $2,300 to $2,100 to cover the current $ 2 Billion shortfall. The Reauthorization Act of 1992 authorized a maximum Pell Grant of $3,700 however Congress only appropriated enough money to cover $2,300 Maximum Pell Grants. If Congress cannot find the money to fully fund the Pell Grant as an entitlement at $3,700, and then seems to have difficulty funding the reduced Pell Grants, how can we be expected to believe that there is the $14 Billion extra each year to replace the capital being currently supplied by private sector lenders?

B) Will put the Administration of the Student Loan Programs in the hands of the United States Department of Education.

   1) The Department has acknowledged the fact they will be unable to administer this program.

   2) OMB, and OIG have questioned the ability of the Department of Education to administer these programs effectively.

C) The lack of ability on the part of the federal government to service these loans will cause the Department of Education to use servicers to service loans. While some servicers such as the Student Loan Marketing Association, and the Education Loan Service Center have provided quality service to students, not all servicers have serviced students well. When students are not serviced well, and when loan deferments are not processed effectively, students are quickly headed for default. The proposed Direct Loan Program could allow the State rather than the schools to make the decision on who will service the school's student loans.

D) While an entitlement nature of federal loan programs has been promised by the advocates of Direct Lending, one would be wise to remain skeptical of such promises. If we cannot seem as a nation to find the money to fully fund the Pell Grant program, why should we believe that the money will somehow appear for a $14 Billion per year Direct Loan Program.

E) Since the Direct Loan Pilot Program is similar to the Perkins Loan Program in many ways, at some point someone will propose the concept of an institutional match for ALL loan programs. This will be crippling to already financially strapped institutions, and withdrawal from the loan programs will be the only remaining option. As loan funds disappear many students will find that they must withdraw from school. This will have a devastating affect on both students and upon institutions already struggling with declining enrollments.

F) Schools will become the lender, and will be subject to due diligence requirements currently assumed by the banking community. These types of requirements have already forced may schools to withdraw from the Perkins Loan Program.

G) Lenders will not stay in the current Federal Family Education Loan Programs(FFEL). Once legislation is approved to phase out the current FFEL Programs, the large lenders who provide ready access to FFEL funds will immediately withdraw from the program leaving only those lenders who are extremely conservative.

1) In the transition years, the students who cannot meet the credit restrictions of the remaining conservative lenders will be denied access to higher education funding. The students who come from "credit wise" families will still be able to get the loan dollars needed. During this transition educational financing will be similar to other types of financing-those who are "credit worthy" will be

able to get loans. However, those who have come back to school because they lost their job, or those who are traditionally represented students may not have the access to higher education that is currently available.

H) Once the banking community has departed from the scene, it may be very difficult to get them to return. Lenders have invested large sums of money into the development of computer systems and in the development of consumer information. Once we have as a nation told these lenders to depart, and once they have found other places to invest their money, why should they be interested in rebuilding the current partnership between education and the banking community.

IV. It is not yet too late-President Clinton should separate his National Service Initiative from the Direct Loan Program. The former is a legitimately good idea that was proposed by candidate Clinton early in his campaign. The latter is not a good idea, which has been through several deaths in Washington.

1) Advocates of Direct Lending are seeking quick full implementation of Direct Lending rather than utilizing the proposed Direct Loan Pilot. If the details of Direct Lending are understood, the program will become unpopular, therefore full implementation must be enacted before President Clinton's popularity begins to deteriorate. In this instance, timing is critically important.

Note: The views expressed in this document are those of the author and do not necessarily represent the positions of either Saginaw Valley State University or the Michigan Student Financial Aid Association.

Eastern Michigan University
Ypsilanti, Michigan 48197

March 30, 1995

The Honorable Bart Gordon
2201 Rayburn Building
Washington, DC 20515-4206

Dear Representative Gordon:

I am writing in response to your letter dated March 22, 1995 regarding Eastern Michigan University's position on direct lending and our experience with the Federal Family Education Loan Program.

Title IV of the Higher Education Act of 1965, as amended, gives universities the option of applying for participation in the William D. Ford Direct Lending Program or remaining in the Federal Family Education Loan (FFEL) program. Eastern Michigan University's administration decided to continue participation in the FFEL program for the following reasons:

- We have had excellent service and results with the FFEL program.
- There is concern about the long-term success with the federal government's ability to service schools, originate loans and collect proceeds during repayment.
- The potential for institutional liability and risk is increased with participation in the direct lending program; particularly in the area of loan origination and account reconciliation.
- Having multiple players in the loan processing arena promotes healthy competition among stakeholders and ultimately improves the final product.
- The law provides us with the opportunity to evaluate the short-term viability of the direct lending program.

If the current law changes and mandatory participation in direct lending is required, Eastern Michigan University will implement and administer the direct lending program. However, we believe a more prudent approach would be to permit a fair comparison of both programs to determine which sector, government or private, is best able to originate loans, deliver proceeds, service consumers and collect repayment.

We are very satisfied with the service provided to Eastern Michigan University students under the Federal Family Education Loan program. In fact, during the past year the quality of service has increased and significant strides have been made in standardizing, simplifying and streamlining all the processes associated with the FFEL program.

The key to further improvment of the Federal Family Education Loan program (or any loan processing system) is automation. Automation, in the form of direct data transfer and electronic funds transfer, speeds up the loan delivery process for students and significantly minimizes paper handling by staff. During the 1994-95 academic year, Eastern Michigan University doubled the amount of loans processed during the peak application period as a direct result of downloading information from our applicant data base to our primary loan servicer (see enclosed charts). This has had a positive impact on customer service and on the day-to-day business of our financial aid office.

Thank you for the opportunity to share our experience with the FFEL program and our position on direct lending.

Sincerely,

Courtney McAnuff
Associate Vice President
University Marketing and Student Affairs

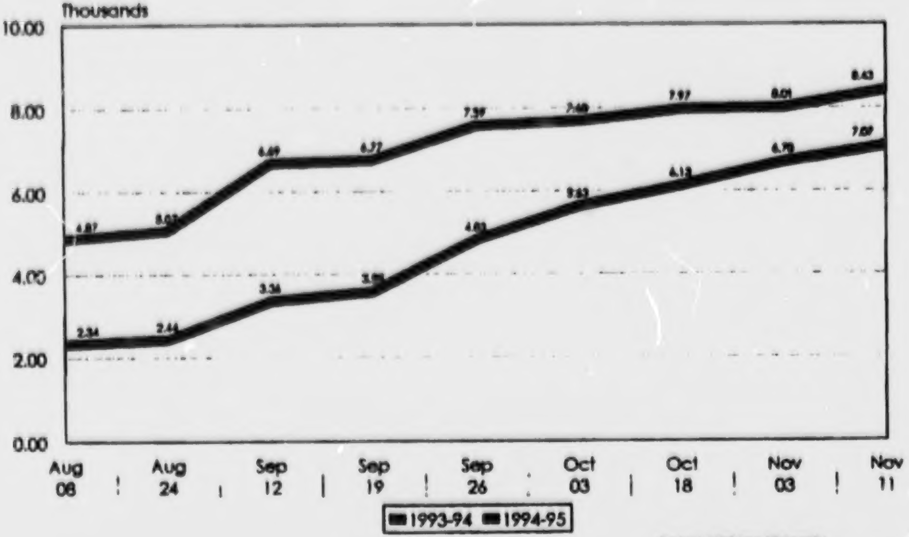
Bernice A. Lindke
Acting Director
Office of Financial Aid

Office of Financial Aid
Division of University Marketing and Student Affairs
403 Pierce Hall
(313) 487-0455

Eastern Michigan University
Office of Financial Aid

Loan Processing

# of Loans Processed - Cumulative Totals



Eastern Michigan University
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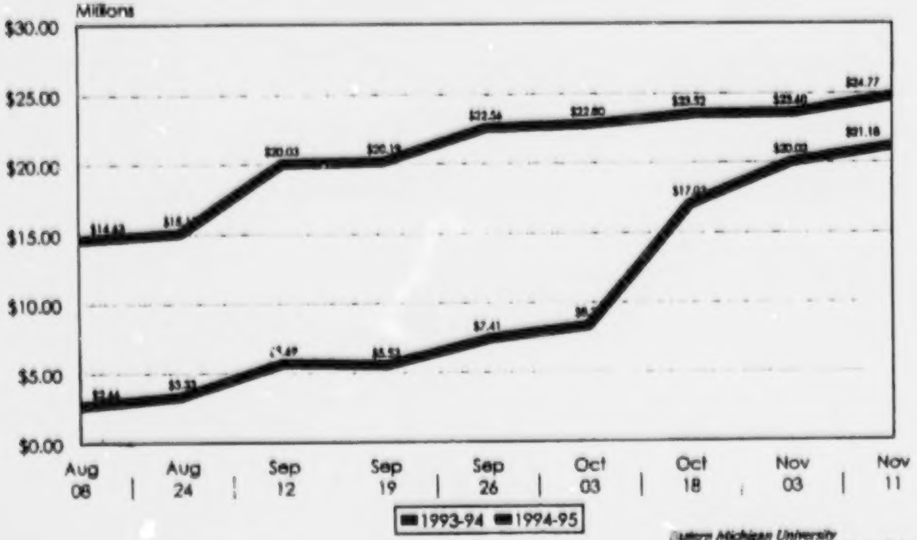
Loan Processing

$ of Loans Processed - Cumulative Totals



Eastern Michigan University
University Marketing and Student Affairs

CLEARY
COLLEGE

April 5, 1995

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The Honorable Congressman Bart Gordon
House of Representatives
103 Cannon House Office Building
Washington, DC 20515

Attention: Ms. Lisa Fox

Dear Congressman Gordon:

We received the summary the STUDENT LOAN EVALUATION AND STABILIZATION ACT [H. R. 530] as well as your letter to our Director of Financial Aid, Rose Smith. We are writing this letter in support of specific issues raised in your bill.

CLEARY COLLEGE'S POSITION ON DIRECT LENDING

We are not opposed to the concept of Direct Lending for students. It is appropriate for students to have a choice between the Federal Family Education Loan and the Federal Direct Student Loan programs. We question the wisdom of a 25 year repayment option as the norm but realize that it may be a necessary exception in some cases.

For us, however, participating in direct lending will require a further upgrading of computer support, increased staff, and an organizational/systems change in the financial assistance areas. We believe in excellence, quality, and customer service, and we know that proper preparation is the key to successful administration. We are cautious regarding the cost benefit to our students.

MANDATORY PARTICIPATION

We are opposed to mandatory participation in a program that we that we believe is not fully tested and cannot be fully tested by the 100% target award year of 1997-98. The Direct Lending program was created as a means to reduce expenses in the student loan program. Schools have not seen proof that this will really be the case once all 7,000 schools participate. As a matter of fact, we believe that much of the cost currently incurred by lenders and guaranty agencies will be passed back to the educational institutions rather than to the Department of Education.

At this point in time, CLEARY COLLEGE is not equipped to handle the increased administrative needs, computer/technological support, nor the potential liability produced by participating in this mandatory program. We believe that Direct Lending appears to be working well for the 106 schools currently participating but are not convinced of smooth sailing once all 7,000 schools are participating.

2170 WASHTENAW AVENUE
YPSILANTI, MICHIGAN 48197
313/483-4400

Accredited by the North Central Association of Colleges and Schools

RICHARD R. CHRYSLER
EDUCATION CENTER
3750 CLEARY DRIVE
HOWELL, MICHIGAN 48843
517/548-3670

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Continued from page 1

SATISFACTION WITH THE FEDERAL FAMILY EDUCATION LOAN PROGRAM (FFELP)
Currently, we are very satisfied with the service that our students receive from the FFEL program. For the 1994-95 award year, we anticipate our total loan volume to approximate $1 million. These are the most valuable services for us in FFELP:

- Adaptability to our internal systems.
- Short turn-around time in processing.
- Adaptability of the Electronic Funds Transfer (EFT) process.
- Monetary incentives to students repaying on time.
- Administrative burden of collection, enrollment confirmation, and due diligence on the lender and guaranty agencies.
- Software training, support and enhancement for electronic processing.

Thank you for the work you have done thus far on the STUDENT LOAN EVALUATION AND STABILIZATION ACT [H. R. 530]. We look forward to the progress of your efforts.

Sincerely,

Thomas Sullivan

Thomas P. Sullivan
President, CLEARY COLLEGE

pc: Rose Smith, Director of Financial Aid
Cheryl Hagen, Vice President of College Relations

Scholarship and Financial Aid

March 28, 1995

The Honorable Bart Gordon
U.S. House of Representatives
2201 Rayburn Building
Washington, DC 20515-4206

Dear Representative Gordon:

Thank you for your letter of March 22. I am happy to respond to your request.

I support your idea to offer a "common sense" option to retain both the FFELP and Direct Loan programs until Direct Lending is fully tested and evaluated.

The University of Detroit Mercy processes Federal Stafford and PLUS Loans for approximately 4,000 students annually. Loan volume in these programs totals some $20 million. We initiated the use of Electronic Fund Transfers (EFT) for FFELP loans at a time when Direct Lending was still on the drawing board. We have found that EFT has accelerated the receipt of loan funds by our students while making the system much easier for them. In addition, the advent of Direct Loans has made the FFELP lenders re-examine their programs and make improvements. The competition between the two systems ensures that each will continue to take bold strides forward in the origination and servicing of student loans.

While Direct Lending may be a good thing, we do not at this time know whether there will actually be any savings, and the loan program has not been around long enough to determine whether the students will receive consistent servicing. It is just too soon to abandon a program that works (FFELP) for one that has not yet had the opportunity to prove itself.

At least until such time as Direct Lending is fully tested, educational institutions should have their choice of programs. They are most qualified to determine what works best for their students. In addition, retaining both programs will keep the competition keen, and that competition can only benefit both the students and the taxpayers.

For the most part, we are satisfied with the service our school and students receive under the FFELP program. In cases where we are dissatisfied with a particular servicer, we have the ability to let that organization know and, if service does not improve, take our business elsewhere. In contrast, the Direct Loan program assigns a servicer, and the school has no choice in the matter, and therefore little or no influence in the level of service. A monopoly doesn't have to be efficient--for better or worse, you're stuck with it.

I hope this information is helpful. If I can be of any more assistance to you, please do not hesitate to contact me. I wish you much success with your common-sense approach to student loan funding.

Sincerely,

Anne Watson

Anne Watson, Director

McNichols Campus
Fisher Administrative Center - Room 200
P.O. Box 19900
Detroit, Michigan 48219-0900
313-993-3350

Outer Drive Campus
Administrative Building - Room G24
P.O. Box 19900
Detroit, Michigan 48219-0900
313-993-6120

Law School Campus
651 East Jefferson
Dowling Hall - Room 133
Detroit, Michigan 48226
313-596-0214

Academic Affairs

UNIVERSITY OF MARYLAND
AT BALTIMORE

STUDENT FINANCIAL AID

March 28, 1995

The Honorable Bart Gordon
United States House of Representatives
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Representative Gordon:

In reply to your letter of March 22, 1995 in which you solicited my input on bipartisan legislation H.R. 530 as it relates to the Ford Federal Direct Loan Program (FDLP); I offer the following that was specifically asked that I address:

My position on FDLP is that the program is feasible. However, issues identified by ED's Office of Inspector General (OIG) and the Advisory Committee on Student Financial Assistance, in its letter to Senator Kassebaum dated March 17, 1995, must be resolved prior to expending the program. At issue are accountability and institutional quality.

If after the FDLP has been through the pilot stage, thoroughly analyzed and evaluated, then, and only then, should mandatory participation be considered.

I am satisfied with the services provided by lenders under the Federal Family Education Loan Program. Lenders can and are making improvements to the electronic transfer of funds.

You may be interested to know that the University of Maryland at Baltimore reversed its decision to participate in the FDLP for the academic year 1995-96.

Thank you for your concerns.

Sincerely,

Ernestine Whiting

Ernestine Whiting
Director of Financial Aid

DONNELLY COLLEGE
608 North 18th Street Kansas City, KS 66102
(913) 621-6070 FAX (913) 621-0354

March 29, 1995

Congress of the United States
Congressman Bart Gordon
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Congressman Gordon:

This is in response to your letter of March 22, 1995.

Donnelly College does not participate in direct lending and is opposed to the concept. Certainly, direct lending should never be made mandatory.

My primary opposition is because of the lack of responsiveness by the Department of Education to questions and issues regarding the FELP which our college has raised with ED. The Department is not customer-oriented and I don't think it can effectively deal with direct lending programs.

For example, our school submitted a request for a recalculation of our 1990 CDR a year ago last January and to date, we have had no response.

I would prefer the system that is now in place. We have a good Guaranty Agency with whom we work. The staff is professional, responsive and customer-oriented. I hope it is left that way.

Sincerely,

John P Murry

John P. Murry
President

JPM:mp

NEWMAN
KANSAS NEWMAN COLLEGE
OFFICE OF THE PRESIDENT

March 30, 1995

Representative Bart Gordon
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Mr. Gordon:

Thank you for your letter, and for inviting input from the college perspective on the critical issue of continued federal funding for our students. The following comments address the particular points in question.

Kansas Newman College opposes expansion of the Direct Lending Program, and prefers continuing with the Federal Family Education Loan Program (FFELP). Participation in the Direct Loan Program could increase the administrative burden for schools, since it would force them to either originate the loan, participate in a consortium, or use an alternative loan originator selected by the Department of Education. Another concern focuses on the Income Contingent Repayment Plan (ICRP) offered through direct lending. While the plan is to lessen the monthly payment of the loan for those students with low incomes and large debt loans, it would also increase the time of the loan as well as the interest which the students pay--a factor which could possibly triple the amount of the loan from that which the student originally borrowed when in school.

I have some reservation regarding mandatory participation in direct lending. To require schools to participate in another federally regulated program -- until there are students who have gone through the whole process from disbursement of the loan to its repayment -- seems somewhat premature. The servicing of the loan is an important issue; how it is done reflects on the school itself.

I am pleased to report that Kansas Newman is very satisfied with the service the school and our students currently receive under the Federal Family Education Loan Program. United Student Aid Group is our main guarantor. The program allows the schools more control over insuring the quickness of receiving student loan funds with less work involved. We are receiving quicker turnaround

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Representative Bart Gordon
March 30, 1995
Page 2

on applications, changes to applications, requests for information, and loan disbursements. Under this program, schools can decide how much or how little liability they want to assume, and how much risk we want to keep with the lender and guarantor.

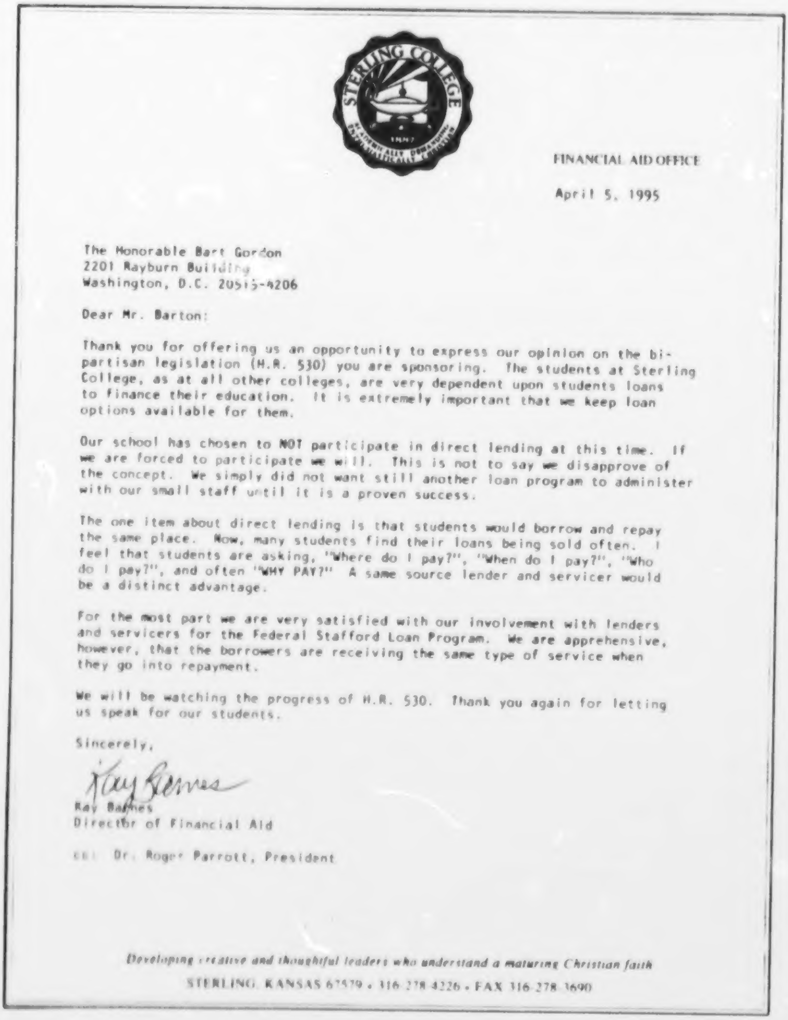
Federal aid allows many students to realize the opportunity of a college education. While congressional efforts to reduce the budget deficit are applaudable, cuts in student aid cannot be justified. I urge you to support continued funding for student loan programs.

Thank you, again, for inviting my input and best wishes to you in your important deliberations!

Sincerely,

Sister Tarcisa Roths
President

STR/gt



FINANCIAL AID OFFICE

April 5, 1995

The Honorable Bart Gordon
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Mr. Barton:

Thank you for offering us an opportunity to express our opinion on the bi-partisan legislation (H.R. 530) you are sponsoring. The students at Sterling College, as at all other colleges, are very dependent upon students loans to finance their education. It is extremely important that we keep loan options available for them.

Our school has chosen to NOT participate in direct lending at this time. If we are forced to participate we will. This is not to say we disapprove of the concept. We simply did not want still another loan program to administer with our small staff until it is a proven success.

The one item about direct lending is that students would borrow and repay the same place. Now, many students find their loans being sold often. I feel that students are asking, "Where do I pay?", "When do I pay?", "Who do I pay?", and often "WHY PAY?" A same source lender and servicer would be a distinct advantage.

For the most part we are very satisfied with our involvement with lenders and servicers for the Federal Stafford Loan Program. We are apprehensive, however, that the borrowers are receiving the same type of service when they go into repayment.

We will be watching the progress of H.R. 530. Thank you again for letting us speak for our students.

Sincerely,

Ray Barnes

Ray Barnes
Director of Financial Aid

cc: Dr. Roger Parrott, President

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University of Notre Dame
Notre Dame, Indiana 46556

Office of Financial Aid
Telephone 219-631-6436

March 28, 1995

Bart Gordon
Member of Congress
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Congressman Gordon:

Thank you for your recent letter regarding the Direct Loan program.

I am enclosing a copy of my personal testimony I will be providing to the Senate Subcommittee later this week. You may find my observations helpful in responding to the questions you raised in your letter.

Thank you.

Sincerely,

Joseph A. Russo
Director of Financial Aid

JAR/cah

Enclosure

TESTIMONY

JOSEPH A. RUSSO

UNITED STATES SENATE
COMMITTEE ON
LABOR AND HUMAN RESOURCES

SUBCOMMITTEE
ON
EDUCATION, ARTS AND HUMANITIES

"OVERSIGHT HEARING ON DIRECT LENDING"

MARCH 30, 1995

Good morning and thank you for inviting me to participate in this very important Senate hearing on the topic of Direct Lending. I come to you today with 30 years experience as a financial aid administrator, the last 17 of which have been as Director of Financial Aid at the University of Notre Dame. Over the last few years, I have also been active in a number of discussions related to student loan reform. Finally, I might add that as a student, I was able to continue my education because of the support made available through government sponsored student loans. The remarks I make before you today are my own and do not necessarily represent the University for which I work.

From the earliest discussions on the issue of loan reform, I have been very supportive of the need for change. The goals of the Direct Loan program have been consistent with those for which I have worked. These included simplicity and efficiency, reduced cost, standardization, and integrity. After many successful years of providing millions of borrowers with billions of dollars of help, the student loan delivery system had become extremely cumbersome. In some instances, other problems related to integrity also became matters of serious concern.

Although the program I began to over-see in 1978 at Notre Dame was exemplary in terms of integrity issues, I learned very quickly that there were many challenges involved for an office which was attempting to serve what is truly a national student body. Every year there are 50 states represented in our student body. Along with this diversity came as many different forms as there were state agencies. Each state worked with numerous lenders. Because of all these players, there was a large range of form designs, data elements, policies, procedures, and later software differences. For example, some states limited the amount that a student could borrow if they did not study in-state. Others had absolute academic requirements which were not always consistent with the institution's policies, thus requiring special handling. Still others had special disbursement arrangements. The reasons for these differences were probably all explainable. In most institutions dealing with primarily in-state students, the challenges were perhaps not as obvious.

In the meantime, the advances in technology were being incorportated into the student loan programs of a few of the larger agencies and national lenders.

Because of the extremely labor intensive and confusing problems for our office, I sought a new way. I wanted a process that was standardized, efficient, simpler, would reduce my administrative costs, and would take advantage of the fast moving technology.

I aggressively surveyed our institution's largest national lenders and likewise made arrangements to pilot test some exciting new software made available by one of our country's national guarantors. In the first year only new borrowers would be directed to this new way of doing things. Data from a common form was electronically transmitted to the guarantor and the approval was received the next day. Lenders who were selected to participate were expected to produce quality results and would be regularly evaluated for service. This service included origination, in school considerations, and equally important to us, the quality of loan servicing.

The pilot project was immensely successful and was phased in over a period of years. Constantly improving technology has made this process even better and continues to do so, even as we speak. Over 85% of our undergraduate borrowers now participate. Lenders who have not kept up their service have been removed from our preferred list. Others whose quality of service have met our expectations have been added.

The Direct Loan competition has been wonderful in respect to accelerating these improvements for our borrowers and our institution. Changes being created by the competition of the Direct Loan program will soon allow virtually any loan, now received on a common application form, from any lender and any guarantor, to be processed through one procedure. Much needed reform, accomplished by our own efforts several years prior to the Direct Loan initiative, is being achieved on a national basis. Without question, not all of the former players will be able to participate in this new world. This will include many lenders and probably a number of quarantors. The economies of scale, the cost of technology, and perhaps other reasons will probably continue to reduce these numbers.

But the bottom line is that loan reform, undertaken here and there by a few institutions working aggressively with the loan industry, is now occurring on a widespread basis. This is not to suggest that all is perfect. More work is needed in the industry and at least some of this can be promoted by improved policy making and support from Congress and the Department of Education.

The big question before us today asks which of these two programs is better. In my opinion, the answer is far from clear. Continuing reforms in the FFELP are still needed yet many questions remain unanswered on the Direct Loan side. As public policymakers, it would seem that any precipitous move, in one direction or the other, would be premature at best and filled with serious uncertainty at the other extreme. In addition to the agreed upon goals referenced earlier, i.e. simplicity, cost reduction, standardization, and integrity, it would seem that the wisdom and vision essential to good policy would also require that a program provide stability, quality of service, and control. Let us examine each of these issues a bit more.

The Department of Education has worked extremely hard to establish a fairly well run, first year Direct Loan program. Given the very limited preparation time and the immense amount of work involved, the Department is to be highly commended. Accolades are also to be given to the 104 first year schools which courageously ventured out into this new world. From all reports issued by the Department, the front end of the Direct Loan first year experience seems to be a great success.

However, will the Department, whose track record in administering far less responsibility in the past in a less than exemplary manner, be able to support the massive volume involved in a full blown program? Why would one want to proceed so quickly down this road, with no safeguards or safety nets, when so many questions regarding administrative capability remain untested? The 104 first year schools wanted to be in the program and were apparently capable of administering it. Will this be the case for 100% of the institutions?

What is even more of a concern for public policy makers should be the issue of quality of service. This is a major concern not only for the front end origination process for thousands of schools and billions of dollars annually; it is perhaps even more of a concern for the billing and collecting side of the program. What will be the quality of service provided by the low bid government contractor? What might be the consequences to the default costs to the taxpayer, the good credit rating of borrowers, and, at least for some of us, the impact on alumni relations for loans which are not properly serviced? Should not this servicing issue be evaluated a little more before we move our entire program into this new, yet to be defined let alone tested, world?

The competition between the two programs has been great for borrowers, schools, and taxpayers. Why would we not want to more fully test and challenge both programs more thoroughly and deliberately? What is the rush, especially given the significant reforms and improvements being generated? An even playing field would allow this important evaluation process to continue, as originally envisioned by Congress.

Would an entirely government run program, without this careful evaluation, be the best way to proceed? There would be no competition, no opportunity to compare programs, and a program totally in control of a Department whose administrative capacity is suspect, especially on the yet to be tested servicing side. Who would be in control? Will problems be more easily resolved by long distance contractors or by campus administrators, working in new ways with lenders and guarantors, which have much at stake? In one scenario, I have at least some control, based upon constant evaluation of quality of services provided, who will be my lender, guarantor, and servicer. In the other, the control is as good as that provided by a government agency or low bid, possibly changing contractor.

There are other issues which still remain in question. From the beginning of this discussion, the projected cost savings for Direct Loans have been remarkably varied, even from the same government agencies. Further complicating the fair evaluation process is the problem of how these savings are to be "scored" in the budget process. I am not an economist nor an accountant. But why can't this evaluation of cost be done in a simple way which measures the full costs of one program in a given year in the same exact manner that these costs are measured for the other program in the same year? I would hope that policy makers can demand such a criterion. I would think that our citizens do!

The expense evaluation process should also require the same definitions and measurements in calculating the cost of loan defaults. Exactly what a defaulted loan will be in the Direct Loan program is still not perfectly clear to me, at least. Indeed, there may also be several still unanswered questions about the Direct Loan repayment options which may be in need of further review. At a base minimum, there should be a clear understanding as to the still unanswered questions regarding cost before proceeding with a full blown program.

Finally, let me conclude with some observations about issues which relate to student loans in general. There is a growing concern among many families about the extent of indebtedness which many of our borrowers will be facing. Loan consolidation may be the answer for some, including those who aspire to lower paying, socially conscious careers. However, the first piece of information we provide our departing borrowers in the exit interview process is reasons why they would not want to consolidate the loans. Yet the decrease in government supported grant programs for needy students may leave these individuals with little or no choice in borrowing...and then perhaps little or no option in career or loan consolidation choices.

Another serious concern in need of your review is the virtually unlimited and unconstrained borrowing limits currently made available through the PLUS program for parents. Except for a poor credit rating check, no provision for reviewing the actual ability of parents to repay these loans is required, according to statute. Is such a policy encouraging unnecessary borrowing? Will these parents be able to make the payments involved? Will institutions be encouraged to increase their costs as a result of this liberal policy? What are the signals we are sending to younger families about the need to plan, save, and sacrifice for their children's education? What will the institution's default rate become for PLUS down the road? What will the cost to taxpayers become? These may be questions worthy of serious review by policy makers.

Of equal concern, but fortunately currently not a widespread practice in the loan industry, is the overly aggressive marketing practices being employed by a restricted number of PLUS lenders. It would be in the best interest of the loan industry to create its own self-regulating expectations in this regard. If not, this may have to become a matter for closer scrutiny at this level.

My final remarks may perhaps be the most important for you to hear today. They again relate to a broader concern being expressed by many in higher education and they relate to the incredible administrative burden being imposed by both statute and especially regulations. The need to control fraud and abuse is very apparent. However, the problems should be readily identifiable by an organization's performance record. For those whose records do not meet certain standards, regulations should be expected. But for those with exemplary records, there should be immediate relief. These standards could include default rates, graduation and placement rates, government audits and program reviews, and fiscal stability. This is not necessarily to suggest that such institutions should be terminated from participating or closed down. It would, however, expect that all or even stricter regulations be required of them. On the other hand, an institution with a very low default, high graduation rates, successful alumni, clean audits, and strong financially, should be relieved of many of these burdens. This is a great example of the need for regulatory reform.

I very much again want to express my appreciation for this very special opportunity to contribute to these discussions. The challenge before us is an important one for our country. I commend you for seeking the input from a practioner such as myself. I would be pleased to attempt to respond to any questions you may have.

Tulsa Junior College

March 29, 1995

Honorable Bart Gordon
House of Representatives
2201 Rayburn Building
Washington, DC 20515-4206

Dear Congressman Gordon:

I am responding to your March 22, 1995 letter concerning the 100% taxpayer funded direct loan program and the current pending legislation on this issue.

I am the Director of Financial Aid at Tulsa Junior College. We have three campuses in the Tulsa, Oklahoma area and are currently building a fourth. Our student enrollment is approximately 20,000 students with 9,000 on student aid; most on a Title IV program. We anticipate processing in excess of 10 million dollars in federal, state and private aid this year.

As Director of Financial Aid at Tulsa Junior College, I have discussed the direct lending a great deal with my staff and other college and university financial aid personnel. As a result of my involvement in financial aid, I cannot support the direct lending concept. My reasons for this are -

(1) Said to be less confusion for the student. The common loan application that has been in place for two years now has virtually eliminated this confusion already. This was a problem when each private lender had their own application.
(2) Reported to be a cost savings to the taxpayer. This has not been proven or even adequately explained how this is to happen. This is also contrary to demonstrated track record of federal agencies.
(3) Department of Education is supposed to be more responsive to student problems. At present, we have an excellent working relationship with individuals in the private sector and do not believe the student will get the same level of personal attention provided by the private lender.
(4) Private lenders also provide Tulsa Junior College and other schools direct personal assistance in our debt management with students. Private lenders provide staffing at our school to assist during peak first of the semester loan disbursals. This has proven to be an excellent time for lenders to visit with our student about fiscal responsibility and good money management practices.

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(5) The private lender also serves as an excellent "check and balance" on proofing the accuracy of the loan application. Should an error occur, one local telephone call and the problem is usually resolved the same day and does not cause a delay in the student receiving funding.

(6) When an institution receives "lump sum" direct lending, this would mandate another layer of administrative processing at the school to process individual loan checks to students. At Tulsa Junior College, this would require additional staff and further delay disbursing funds to the student. With the private lender, the checks are already prepared for the individual student and requires little additional processing to make the disbursal.

In conclusion, my responses to your three specific points are -

* Position on direct lending.
  Not in favor for reasons already given.
* Mandatory participation.
  This is a case of trying to force into existence a concept which shools have reviewed and a majority rejected as less effective than the program already in place.
* Satisfaction with FFELP program.
  Is providing an excellent service to the student. System could be improved with more timely notice of loans going into default so as to preclude disbursements after student goes into default. I also question the ease with which a borrower may now get out of default.

Sincerely,

Robert E. Tally
Director,
Financial Aid

ret:tmh

BACONE COLLEGE Muskogee, Oklahoma 74403 918 / 683-4581

March 28, 1995

Honorable Bart Gordon
6th District, Tennessee
Congress of the United States
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Honorable Gordon:

Thank you for your letter dated March 22, 1995 regarding the bi-partisan legislation (H.R. 530) and direct lending. I support you 100% and pray that the Administration will not propose an accelerated move to a 100 percent participation.

I suppose I have already addressed my position on direct lending in the above paragraph, but I am strongly against it at Bacone College. My reasons are that it would require another full-time person to administer the program. It would require hiring a billing service to keep up with the tremendous paperwork involved.

I feel that mandatory participation in direct lending may be right for some schools, but for a small independent private college like ours it simply is not feasible. I will not support mandatory participation and have discussed this matter with the President of the college and he concurs.

We believe that the school and our students are satisfied with the service received under the Family Education Loan Program. The only improvement needed is electronic transmission, to speed up delivery of student loans.

Thanks again for writing and I hope my input will be helpful.

Sincerely,

Sarah Morgan

Sarah Morgan
Financial Aid Director

SM:me

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MSC

Financial Aid

Murray State College

Tishomingo, Oklahoma 73460

March 27, 1995

Congressman Bart Gordon
2201 Rayburn Building
Washington, DC 20515-4206

Dear Congressman Gordon:

As a Financial Aid Administrator I have some concerns about the ability of the Direct Lending Program to meet the needs of our students. I also have serious concerns about the U. S. Department of Education's ability to handle a larger portion of the loan volume as well as the government's ability to insure that the funding to make these loans remains available in future years. Based on the information to date, I seriously doubt that the projected savings are realistic and it appears that some of the costs of maintaining the Direct Lending Program are not being considered.

Murray State College has been extremely satisfied with the service our students receive under the Federal Family Education Loan Program. The lenders and guarantors in this program have been responsive to the needs of our students as well as this institution. As a result of the competition amongst the lenders, all of the participants have striven to improve their services. I am concerned that the lack of competition in the Direct Lending Program will offer little incentive to improve services. Our institution also receives excellent training and support under the Federal Family Education Loan Program. Although I am sure the U. S. Department of Education will offer training, they often provide their training at locations too far away for most schools to economically attend. Our guarantor currently provides local training at no cost to the institution. In addition, they are willing to come onto the campus and provide staff training.

I believe that it would not be in the best interests of our school and the students we serve to require mandatory participation in direct lending until such time as the program has been proven to be both cost-effective and in the best interest of the participants. I am also concerned about the proposal to eliminate the interest subsidies on the loan programs. Murray State College serves a large population of low-income families. Approximately seventy-five percent of our applicants have a zero Effective Family Contribution. Eliminating these subsidies will have an extremely negative impact on our students as well as other low-income students nation-wide.

If you need any additional information, please contact me.

Sincerely,

Marilyn Schwarz

Marilyn Schwarz
Financial Aid Director

Northeastern Oklahoma
A&M College

200 I Street NE
Miami, Oklahoma 74354-6497
(918) 542-8441

March 30, 1995

Congressman Bart Gordon
U. S. House of Representatives
Washington, DC 20515

Dear Congressman Gordon:

Ms. Sherry Clayton, our College's Director of Financial Aid, provided me a copy of your March 22, 1995 letter regarding direct lending.

My responsibilities include oversight of the disbursement process of student financial aid, both Federal and State. I trust that your invitation for input on this issue from campus officials extended to those involved with all aspects of the financial aid process such as me.

Our College is a comprehensive public community college offering 2-year associate degrees, numerous transfer programs, occupational certificate programs, and various specialized educational oppportunities for local citizens and industries. Our annual FTE approximates 2,200.

During the current school year we have already serviced 723 students receiving Federally supported student loans and expect more during the next three weeks of the current semester plus additional ones during the summer term. While we rely on three primary lenders for providing these loans, a considerable number of other financial institutions also provide loans when asked to do so by students.

Because of our relatively small size and consequently limited resources, direct lending would pose a very real problem if we were required to obtain lending and collections expertise and the necessary computerized support for loan processing and tracking. Our three primary lenders, two major commercial banks and the Oklahoma Student Loan Authority, obviously possess such staff expertise and system capabilities by virtue of the nature of their business.

Three other factors impact our College's situation concerning the capability to implement direct lending.

One would be our ability to attract qualified lending/collection personnel because of our salary structure. (Last year I completed six years as a director of a $30+ million dollar credit union. Although I no longer serve in that position, I do know the difficulties that our College would encounter because we could not offer competitive salaries for qualified personnel.)

Another is the State's current concerted efforts to further reduce administrative costs within higher education institutions. While we already feel that we are at the bare-bones point, we may still be required to down-size even more.

Thirdly, there is the matter of Oklahoma's balanced-budget requirement. Due to foreseen funding limitations, our Governor recently imposed a hiring freeze on new positions. Estimating a date for the lifing of this freeze would only be conjecture at this time. But I certainly doubt that it will be any time soon.

The burden to higher education to fund personnel and computerized systems necessary to support direct lending will be considerable. Only one higher education institution in Oklahoma, one of our flagship universities, is participating in direct lending. And we know of no others with plans to do so. I firmly believe that the problems listed above that our College would face would also be shared by hundreds of higher education institutions throughout the nation. **After all, the product of colleges and universities is education, NOT consumer lending.**

The Administration's proposal falls in the area of "unfunded mandates", a subject that is receiving considerable national attention, and rightfully so. I personally believe that forcing Northeastern Oklahoma A&M College to participate in direct lending would be detrimental to our College's programs, students, and future.

Thus I concur with the effort to repeal all direct lending. Your intent of keeping loan options open for schools is appreciated. And I would hope that if direct lending remains, participation would continue to be optional rather than mandatory.

Thank you for affording me the opportunity of sharing my views on this crucial issue.

Sincerely,

Gary R. L

Gary R. Lair, CPA
Chief Accountant

xc: Dr. J. Carroll
T. Poole
S. Clayton
Dr. G. Rogers

Oklahoma State University
OKLAHOMA CITY

Office of Financial Aid
900 North Portland Avenue
Oklahoma City, Oklahoma 73107-6195
405-945-3319, FAX 405-945-3277

The Honorable Bart Gordon
2201 Rayburn Building
Washington, DC 20515-4206

March 28, 1995

Dear Representative Gordon,

I appreciate your interest in higher education, specifically the federal education assistance programs that this country makes available to our many citizens seeking to further educate themselves. I also wish to thank you for the opportunity to share with you my concerns of institutions being forced into the direct lending program.

Oklahoma State University - Oklahoma City is an Oklahoma City metro 2-year college. Our enrollment is approximately 5,000 students strong. We compete with several metro area community colleges and junior colleges throughout this area.

Even though we bear the name Oklahoma State University, we are operated separately from the 4-year main campus of Oklahoma State University located in Stillwater, Oklahoma. Our only real ties with the main campus is the housing of our fiscal accounts. We, in fact, pay OSU-Stillwater to monitor our payroll, fiscal and financial aid accounts. They perform very little in the way of reporting as my office is still responsible for our FISAP and Pell Grant expenditures. In order for us to give our students their Pell Grant and SEOG money, we are required to order the money from Stillwater, Oklahoma. They in turn draw down the funds to our accounts, produce the checks and campus mail them back here to Oklahoma City. Our Business Office does not presently have check cutting capabilities.

This procedure alone makes it is easy to see the problems we would have with direct lending. Participating in the FFEL programs allow this Financial Aid Office the ability to electronically file loan applications and in some instances receive a loan check for that student in less than 48 hours. By forcing OSU-OKC into direct lending, we would be forced to requisition the accounting department in Stillwater, Oklahoma to cut the checks and then hopefully receive the checks back within 3 to 7 business days. If the Stillwater accounting office is busy with checks for the main campus, our checks could be delayed nearly two weeks.

Sometime in the future (3-5 years) our Business Office hopes to gain the ability to cut checks but it still would be a few years down the line from that before they could handle the volume of our 2.5 million dollar student loan account.

Another critical issue for our institution would be handling the reconciliation of such a large account. We currently handle nearly 5 million dollars in total aid (nearly a 50% increase in five years). In the past five years, our staffing has not increased, however we managed to gain some relief when our Admission staff agreed to assist us in providing basic information for our financial aid students. The State of Oklahoma has now issued a hiring freeze for higher education and simultaneously we lost one of our Admissions/Financial Aid Officer positions. As you can see, our biggest dilemma is handling our customers and trying to maintain a high standard within the programs that we are currently responsible for. We have no extra position that could deal with reconciling such a huge account and there is little hope that we would be able to acquire one anytime in the near future.

Please sir, do not let Congress forget about the smaller public institutions that operate on a small amount of state appropriations. I know that there must be many other schools in the same position we are in. It would be detrimental to these financial aid offices to take on the task of direct lending. Congress must also realize that many schools like OSU-OKC are given the order to sign up for direct lending by their President without any chance to express their concerns but yet are ultimately held responsible for administering the program properly. I have been lucky thus far to have had some administrators who have realized that we are not ready for such a task. There are many who are not as fortunate as I.

The FFEL Programs, themselves, are not perfect however they have improved greatly due to the competition of direct lending. Procedures have been eliminated, applications have been standardized and electronic means have been implemented. As stated earlier, there is no doubt that for OSU-OKC, receiving checks would be faster by utilizing the FFEL program as opposed to the lengthy and time-consuming position direct lending would place us in.

I certainly do appreciate your reading my letter and I hope that you will continue to fight to at least maintain an institution's right to choose which program is best suited for them. If every institution is forced to participate, it is the Financial Aid Office and it's staff that will pay the ultimate price of failure. That would be a shame because most of this nation's financial aid administrators are the most hardworking, dedicated, innovative, thoughtful, accurate, unselfish, underpaid professionals in this country.

If I can be of any further service to you, please do not hesitate to call. (405) 945-3211

Sincerely,

Nancy Bradley

Nancy Bradley
Coordinator of Financial Aid

WCC — WILKES COMMUNITY COLLEGE

P.O. Box 120, Collegiate Drive
Wilkesboro, NC 28697-0120

919/651-8600
FAX 919/651-8749

FINANCIAL AID OFFICE

910-651-8633

March 27, 1995

The Honorable Bart Gordon
6th District, Tennessee
2201 Rayburn Building
Washington, DC 20515-4206

Dear Congressman Gordon:

Thank you for your 22 March 1995 letter concerning the debate of future federally supported student loans.

My position on direct lending is that I do not favor a move to 100 percent direct lending. For small community colleges like mine, a real need for direct lending is not necessary. During 1994-95, we have assisted approximately 90 students with Federal Stafford Loans totaling $220,000.00. In my opinion, there is no need to make schools like myself participate in direct lending because we are not dealing with alot of student borrowers. We are also a low cost state supported institution (maximum tuition per quarter is only $185.50); therefore our students will probably not experience the urgency of needing loan funds as they could experience in other larger schools.

I am very satisfied with the services I and my students receive under the FELP. The only improvement I need to make is to file all loan applications I process and certify electronically with a lender. I am already looking into this at present.

I appreciate your work on this issue and do appreciate you taking the time to write to me and to ask for my thoughts and concerns.

Sincerely,

Alan G. Whittington

Alan G. Whittington
Financial Aid Counselor

AGW/vgc

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Jefferson, NC 28640
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Sparta, NC 28675
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Past, Present, and Future

April 3, 1995

The Honorable Bart Gordon
Congressman, 6th District, Tennessee
2201 Rayburn Building
Washington, DC 20515-4206

Dear Representative Gordon:

Thank you for your letter and the opportunity to respond to the issues you raise. As background, I am a member of the board of Sallie Mae and therefore could be perceived as having other than an institutional interest in the outcome of the direct lending situation. Nevertheless, I have a strong interest in the issue as an educator of some experience with government programs, particularly those that deal with student loans.

What follows are my responses to your specific questions:

- My position on direct lending and my reasons for that position -- I believe that the direct lending program is unproved. However, it deserves an opportunity to compete in the market. That should be a fair competition which allows institutions to choose direct lending or the current Family Education Loan Program (FELP), depending on which best serves their own students and families. If the direct loan program proves highly attractive, that will stimulate FELP to make whatever accommodations will keep it competitive. If direct lending wins the participation of a greater number of institutions, then the government's program is an unqualified success. If, on the other hand, direct lending does not attract sufficient participation, I don't believe it should be propped up with taxpayer funds. I emphasize, though, that Congress must ensure that this is a fair trial with no artificial supports for either direct lending or FELP. That is the only way we can see what will best serve all interests.

CHANCELLOR AND PRESIDENT
300 Tolley Administration Building
Syracuse, New York 13244-1100 · 315-443-2235 · Fax 315-443-3503

- My position on mandatory participation in direct lending -- Forced participation would nullify fair competition. I fear that government would be tempted to trim services to "save taxpayer money," and thus make this a less and less responsive program. But fair competition would allow the best, most user-friendly system to emerge. It's the same theory that calls for the removal of tariffs or allows some government agencies (including state education systems) to try private vendors as a way of comparing costs and efficiency. I believe that the benefits of competition are part of human nature.

- Current satisfaction with FELP at Syracuse University and suggestions for improvement -- FELP has served students and families here well over the years. It has provided fairly easy access and, at least at Syracuse, minimal default. Of course, FELP products and services can always be improved, something I think will happen more rapidly with the competition of direct lending. The most frequent complaint from our financial aid staff concerns the large number of service providers they must coordinate. I believe that competition on a level playing field will help simplify matters.

In short, I believe it would be unwise to allow the direct lending program to exceed 50 percent for the next 10 years, at least. This would provide ample time to make comparisons in terms of processing, servicing, and collecting and to determine customer preferences.

Again, thank you for the chance to comment on this vital issue.

Sincerely,

KAShaw

Kenneth A. Shaw

New Mexico Tech
Office of the President

Socorro, NM 87801
Telephone (505) 835-5600
Facsimile (505) 835-6329

April 5, 1995

The Honorable Bart Gordon
Congress of the United States
House of Representatives
2201 Rayburn Building
Washington, DC 20515-4231

Dear Congressman Gordon:

As President of New Mexico Institute of Mining and Technology, I appreciate the opportunity to offer my support to H.R. 530. I concur that more time should be given to testing the Direct Lending Program before requiring 100-percent participating by all postsecondary institutions participating in the Federal Family Educational Loan Program (FFELP).

When the Direct Lending Program was introduced during the Bush administration, the intent was to have a pilot program before enacting the full-fledged program. However, with the change of administration in 1993, the pilot was scratched and the Direct Loan Program was initiated with a 20-percent participation in the first year and projected 100-percent participation by the 1997-1998 academic year.

At this time, New Mexico Tech does not support the 100-percent participation by 1997. Specifically, because of the newness of this program, the collection end has not been tested. The full collection process will not be in place for two or three years. There is no way of knowing in 1997 if the collection process proposed in Direct Lending regulations will be as effective as predicted and reduce the national default rates.

In New Mexico, we are very fortunate to have a very efficient secondary market that collects loans guaranteed by New Mexico Student Loan Guarantee Corporation. The most recent cohort default rate (for 1992) for New Mexico is only 7.1 percent. The default rate for NMSLGC loans serviced by New Mexico Education Assistance Foundation is 5.4 percent. New Mexico Tech's default rate for 1992 was 0.9 percent. These low rates are because of the efforts of the Foundation and the close marketing relationship it maintains with the postsecondary institutions in New Mexico. Telephone calls between a school representative and personnel at the Foundation quite frequently resolve a delinquency before it becomes a default. We do not believe this type of interaction between school and collection personnel will be possible with Direct Lending.

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The Honorable Bart Gordon
Page 2
April 5, 1995

There are problems with the FFELP; however, most of them are being corrected. For example, turn-around time from the time a school certifies a loan until a check is disbursed has been reduced because of the electronic guarantee process. When funds are disbursed by electric transfer the time will be reduced even more.

It is our hope that H.R. 530 is approved. More time is needed to analyze the effectiveness of the Direct Lending Program before requiring 100-percent participation. More time is needed to determine whether the projected cost savings of the Direct Lending Program will be realized.

We appreciate your support of financial aid programs.

Sincerely,

Daniel H. Lopez
President

DHL/lc

March 28, 1995

Honorable Bart Gordon
2201 Rayburn Building
Washington, DC 20515-4206

Dear Sir:

I appreciate the opportunity to express the views of College of the Southwest pertaining to direct lending. The College was founded and still operates under principles of a Christian education, debt free operation and a belief in free enterprise.

The College believes in and has publicly stated our opposition to mandatory direct lending. Competition should be the force to legislate cost control and efficiency and not government mandate. I can not think of one good or service with a single supplier where the public benefits more than if competition existed and is encouraged. America was founded in freedom and a college should be allowed the freedom of choice to participate without retribution. The college knows. of very few government programs run more efficiently than private enterprise can furnish.

Students are satisfied with the selection of available private lenders. The New Mexico Guarantee Association has one of the lowest default rates nation-wide while providing timely, quality service. New Mexico benefits financially from the current system. Monies are funded back to the local economy, jobs are created and problems are addressed locally. New Mexico should not be punished because some states have high default rates.

The only improvement that would benefit schools would be a national network to track lenders from school to school and lender to lender. Problems arise as students attempt to disguise default status in other states.

Your interest in our opinion is important and appreciated by College of the Southwest. We look forward to contact in the future.

Sincerely,

David Arnold

David Arnold
Financial Aid Director

DA/cs

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University of
Nebraska at
Kearney

Office of Financial Aid
Kearney, NE 68849-2350
(308) 865-8520
FAX (308) 865-8157

March 30, 1995

The Honorable Bart Gordon
U.S. House of Representatives
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Congressman Gordon:

I welcome your interest in the Federal Student Loan Programs and wish to let you know of the feelings of the University of Nebraska at Kearney.

We have chosen not to apply for the Direct Lending Program due to the fact that we have an exceptionally efficient process currently in place with the Federal Stafford Loan program. This program and the process expeditiously meets the needs of our students. The partnership between our guarantee agency, our major lenders and the university provide an effectively managed loan program that is easy for the student to understand and apply for.

As the participants in the Stafford Loan Program cooperate more and standardize policies and procedures we see the program becoming more and more easy to administer. Any effort to force participation in the Direct Lending would be unfortunate. Most simply put, we have the ability to better serve our students through the Stafford Loan Program.

Sincerely,

Patrick McTee
Director of Financial Aid

University of Nebraska at Kearney • University of Nebraska Medical Center • University of Nebraska at Omaha • University of Nebraska-Lincoln

BELLEVUE
UNIVERSITY
OFFICE OF FINANCIAL AID AND VETERAN SERVICES

March 30, 1995

The Honorable Bart Gordon
U S House of Representatives
2201 Rayburn Building
Washington, D C 20515-4206

Dear Congressman Gordon

Thank you for asking for our opinion regarding direct lending and the FFEL Program We do not desire to participate in the direct lending program Our initial concerns with this program were Can the government effectively administer a program of this magnitude? How will our institution afford direct lending? Unfortunately, nothing has happened in the last two years either to alleviate our concerns about direct lending or to diminish our confidence in the continued ability of the FFEL Program to meet the needs of our students

Although direct lending has been in effect a short period of time, the Department of Education has expended large amounts of resources (money and labor), to publicize and promote direct lending We feel these resources could have been better utilized, and certainly hope these expenditures are computed into any alleged savings from direct lending

Our number one priority and our expertise is in providing a quality education for our students We feel that mandatory participation is an infringement on our rights and unfair to our students Schools should have the choice of what lenders provide the best service to their students Private enterprise has always been more capable of providing quality customer service than the federal government Our students receive excellent service from the existing FFEL Program We now benefit from the competitive environment in the student loan industry If that environment changes, I doubt that we will have the same level of customer service and technological innovation now available through the private-lender based program

Thanks you again for the opportunity to discuss this important issue Please do not hesitate to call me if you have any questions or need additional information

Sincerely

Jan M. Dotterer
Director of Financial Aid and Veteran Services

1000 Galvin Road South
Bellevue, Nebraska 68005-3098
Phone (402) 291-8100

Nebraska
WESLEYAN
University

5000 Saint Paul Ave.
Lincoln, NE 68504-2796
402/466-2371

March 31, 1995

The Honorable Bart Gordon
2201 Rayburn Bldg
Washington, DC 20515-4206

Dear Representative Gordon:

Thank you for your letter inviting my input in behalf of Nebraska Wesleyan University regarding direct lending.

Nebraska Wesleyan University is a 4 year undergraduate liberal arts college located in Nebraska's capital city. Fourteen hundred full time students and approximately three hundred part time students are enrolled each year. For both 1993-1994 and 1994-95, our students borrowed under the Federal Stafford Loan program nearly $3,200,000, and their parents borrowed nearly $500,000 under the Parents Loan program (PLUS).

We do not wish to participate in direct lending. From our perspective the Federal Stafford Loan program is not broken and does not need to be replaced with direct lending. Our students and we in the Financial Aid Office receive fast, efficient, and courteous service from both lenders and guarantee agencies. As a result, I see no advantage for us to change from a working system to one that is still unproven in its ability to deliver what it claims.

Sincerely,

Claire Fredstrom
Director of Financial Aid

CF:lv

YORK COLLEGE
1890

"Educating Minds and Hearts in America's Heartland"

March 27, 1995

Bart Gordon
2201 Rayburn Building
Washington, DC 20515-4206

Dear Congressman:

Thank you for going out of your way to seek the Financial Aid Director's position on Direct Lending.

In response to you questions, I offer the following opinions:

> My position on Direct Lending is that it is and can be a viable option for students. Students should have the option to choose where they want to borrow their loan funds from. The current position of Direct Lending is that the school decides where a student borrows their money from. Some thing else to survey would be, if given the choice to borrow from a bank of your choice or directly from the government, how many students would choose the government? I also believe that competition entices quality. By taking competition out of the student loan business the quality of the programs will decrease. The Financial Aid Offices have already seen an increase in quality from lending institutions since Direct Lending was introduced.
>
> Your second question concerning my feelings about mandatory participation in Direct Lending is easy for me to answer. I am against mandatory participation in Direct Lending for the same reasons stated above.
>
> Currently we are satisfied with the services we receive from the lenders our students have chosen. However, because of the new audit requirements effective July 1, 1995 our local lenders have decided to no longer participate in student loans. They believe the new requirements would cause them to incur a loss on the program. I do think we need to be careful not to serendipitously cause a monopoly in the student loan lender business.

912 Kiplinger, York, Nebraska 68467-2699
(402) 362-4441 • FAX (402) 363-5623

To continue to improve service for the students, I would recommend that Direct Lending be an option for the students along with the lenders of their choice. I do not recommend that a school be forced to choose between Direct Lending and bank lending.

Thank you again for taking the initiative to find out what the financial community wants to see concerning student loans.

Sincerely,

Debra L

Debra Snider
Director of Financial Aid

mm

Willmar Technical College
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(612) 235-5114 • 1-800-722-1151 MN Toll Free
Fax (612) 235-0601

March 29, 1995

Bart Gorden, Congressman
6th District, Tennessee
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Congressman Gorden,

I am writing in regard to H.R. 530 which would permit a viable guaranteed student loan program as a competitive alternative during the testing of The Federal Direct Loan program.

I would like to support this bill as it will keep options open for Regions and Colleges within those regions, that are being more than adequately served by the "traditional" FFELP" program.

There are colleges in our county that have not received the cooperation, support and commitment of Lenders and Guarantee Agencies, such as we have had in Minnesota. No doubt those colleges need an alternative, for example, direct lending, but please don't fix something that does not need fixing for us.

Thank You

Jon Griepentrog

Jon Griepentrog
Financial Aid Director

aa

A Campus of
Hutchinson - Willmar Regional Technical College
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ST. CLOUD STATE
UNIVERSITY
OFFICE OF SCHOLARSHIPS AND FINANCIAL AID
106 Administrative Services Building
720 Fourth Avenue South
St. Cloud, MN 56301-4498
Phone (612) 255-2047

April 7, 1995

Representative Bart Gordon
House of Representatives
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Representative Gordon:

Thank you for your recent letter and the opportunity to respond to your questions related to the federal Direct Loan Program. I sincerely appreciate your willingness to contact individual financial aid directors to obtain our input, advice, and opinions. We work with the student loan programs on a daily basis and are the closest to the administration of the programs.

I feel it is essential to keep loan program options available to enable schools to choose which program they wish to participate in. I firmly believe that House Bill H.R. 530 makes a lot of common sense to cap the Direct Loan Program at 40%. Direct Lending needs to be thoroughly tested and evaluated before it gets out of control. I am not convinced that the Direct Loan Program will save any money and believe previous savings estimates have been grossly overstated. Moving to a 100% Direct Lending scenario in my opinion is a mistake at this time. I have been involved in student aid administration for approximately 28 years and have observed the federal government's role in higher education and the administration of the student aid programs by the Department of Education for many years. I am not convinced that the Department of Education can effectively manage a program of this magnitude efficiently and effectively. The Department of Education has established a reputation related to its inability to manage the federal Pell Grant Program. The Department is constantly overspent and has a huge funding shortfall or it has a funding surplus in this program. Since 1975 over 4,000 students have received grants ranging from 11 to 17 years. This demonstrates total lack of oversight by the department. I agree with House Speaker Newt Gingrich's statements indicating that the federal government is incompetent at almost every direct service it provides and in the end will do to student loans what it has done to public housing. Large central systems will ultimately fail. It is easy to originate loans but to track, service, and collect the funds is another matter.

St. Cloud State University is a four year public institution with an enrollment of approximately 15,000 students. We provide approximately $13.8 million in subsidized Stafford Loans to approximately 4,950 students and

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approximately $4.83 million of unsubsidized Stafford loans to 1,840 students annually. We have an annual cohort default rate of approximately 5.3%. We feel that we have a very efficient loan delivery system in place at St. Cloud State. We manage our highly automated loan program with 1.5 full-time support persons, 2 student assistants, and the services of .75 professional/ administrator. Over the years we have developed and perfected a very cost effective and customer service oriented loan program through our outstanding working relationships with our lenders and guarantee agencies. On a bi-weekly basis we electronically transmit loan data to four guarantee agencies (United Student Aid Funds, Fishers, Indiana; Northstar Guarantee, Inc., St. Paul, Minnesota; Great Lakes Higher Education Corporation, Madison, Wisconsin; and Education Assistance Corporation, Aberdeen, South Dakota), and we do significant amounts of loan volume with approximately 15 lenders. With private enterprise at work, we have experienced immense competition among these agencies and lenders to provide fast, efficient, and cost effective service to our students. The lenders and guarantee agencies provide us with significant amounts of information, training, and printed material to assist us with the daily administration of the FFEL loan program. If we are to move toward Direct Lending, I am sure our loan administration costs would significantly increase and we would be required to perform more functions. At the present time, I am convinced that I should not trash a well designed, highly automated, tested, and proven delivery system which has been developed and perfected over the past 15 years for an unknown system. In addition, unresolved questions still exist related to increased institutional liability under Direct Lending.

If it is believed that the lenders and guarantee agencies are making excessive profits on the Stafford Loan Program at the expense of taxpayers and students, measures can be implemented to squeeze the margins on lenders and guarantee agencies. The federal government has the authority to call in guarantee agency reserves if it so desires. In addition, the federal government can further limit the administrative cost allowance guarantee agencies receive and reduce the in school subsidies paid to lenders. Perhaps the most important thing that needs to be done is to eliminate the high default schools from participation in the program. High default rates add enormous costs to the program whether it is the FFEL or Direct Lending Program.

I feel it is important to provide the Direct Lending option to schools located in states where significant problems exist with the current FFEL program. This is not the case in Minnesota. The Direct Lending Program should be considered an alternative and not a mandate. Since the federal government has gotten involved in the student loan business through Direct Lending, it has amazed me to see how some of the rules and regulations that were once etched in stone have been changed with little difficulty since the department has gotten into the loan business. It is essential that the playing field for the Direct Loan Program and FFEL Program be kept level. The rules of the game for both programs should be identical.

On the positive side, with the advent of Direct Lending, we have seen significant improvements in the FFEL loan program. With the addition of another player in the market place (Direct Lending), the competition and cooperation to provide even better customer service to schools and students has intensified. Enhanced customer service has been the main theme. Increased pressures by lenders demanding more effective and accurate loan servicing on the part of loan servicers has been taking place. In fact one of our major lenders has opened up its own servicing center. For example, guarantee agencies and lenders have worked together and have developed a common Stafford Loan application and promissory note, developed the "common line" electronic format for the transmission of student loan data, developed common and uniform PC based products, worked extremely hard in Minnesota to promote and implement the electronic transfer of funds (EFT), encouraged and facilitated participation in the National Student Loan Clearinghouse. This spring the major guarantee agencies will be providing a common update and training session for schools participating in the FFEL loan program. A common training session leads to common policies and procedures.

In conclusion, I have little confidence in the Department of Education. Two former Secretaries of Education, William Bennent and Lamar Alexander have recommended that the Department of Education should be abolished. Maybe they know something that I don't. As a taxpayer, I personally become very concerned about the amount of money that has been spent on the promotion and advertising of the Direct Loan Program. If the Direct Loan Program is that effective, the best advertising will be by word of mouth from extremely satisfied customers. I am also concerned about the amount of money that the Department of Education currently spends supporting the Transitional Guarantee Agency (TGA). I feel that this agency is not necessary and represents a large and unnecessary expenditure of federal tax dollars. The TGA is run by many of the same people who managed, or should I say mismanaged, the Higher Education Assistance Foundation (HEAF). The Department of Education's expenditure was enormous related to the HEAF winddown. In my opinion, the Department of Education chose perhaps the most expensive alternative when it closed down HEAF. It is true that the Department of Education has worked hard to attempt to provide quality products and customer service to the initial 104 institutions participating in the Direct Loan Program. However, if it is mandated that all schools must participate in Direct Lending, I would venture to say that the quality of products, services, and response to questions will very quickly deteriorate.

In summary, I believe that competition is good and competition will produce the best product at the lowest cost. If the Direct Lending Program is the only option, competition is eliminated, schools then become mere extensions of the federal government and a federal bureaucracy. With the Department of Education in control, schools will not be an equal partner in the process. The department has a tendency to micro-manage and gets regulations passed for everyone in its attempt to catch a few big abusers. I feel it is important to keep the federal government's involvement to a minimum and out of peoples lives. However, I feel the federal government's responsibility is to conduct audit and program reviews, effectively deal with abusers, and to insure that programs are being administered according to the intent of Congress.

If you have any questions regarding this letter, please feel free to contact me.

Sincerely,

Frank E. Loncorich, Director
Office of Scholarships and Financial aid

FEL:jah

REDLANDS
COMMUNITY COLLEGE

April 3, 1995

Honorable Bart Gordon
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Mr. Gordon:

Thank you for your interest in studying the impact of direct lending. I have been in financial aid for over twelve years, and worked at both the university and community college level.

I appreciate any members of Congress who are willing to take a closer look at direct lending before making it mandatory. I am opposed to direct lending for the following reasons:

1. As a taxpayer, I do not believe changing a major student loan system will save me money. I see implementation of a new system costing more. Basically, the taxpayer will foot the bill, with no professionals collecting repayment.

2. The majority of schools do not have the capacity to manage the direct loan program. The program requires precise recordkeeping most schools are not set up to maintain, in terms of loan data. Not all schools even have the Perkins Loan program, which helps some in terms of dealing with loan records and repayment. However, even schools who have Business Office personnel accustomed to handling Perkins Loans, are not staffed to deal with the major recordkeeping and billing of Direct Loans.

3. With all of the current ever-changing regulations governing financial aid, our offices are already understaffed. Most schools do not have funds to hire additional employees to manage direct lending. I see a potential administrative nightmare approaching.

4. The current lender/guarantee agency system has become a fine-tuned system we can rely on for accurate information and processing. Few schools, if any, will actually be able to get funds to students faster. Under the current system the schools have enough regulations to

handle. We do not need lender regulations, also. Also, now you have schools, lenders, and guarantee agencies all working to get the borrower to rapay.

This brings me to a general concern about student loans. Schools are currently under a heavy burden of regulations concerning the eligibility determination and processing of student loans. Mistakes can cause school liability. Also, default rates penalize the schools. Why would Congress think it is important to get loan funds to students quicker? Maybe we should be more cautious about who qualifies for loans.

My real concern is that by eliminating the professionals (lenders and guarantee agencies) in the loan business, the potential for default is greater. That is already a major national concern.

If a school, especially a small school, cannot afford to participate in direct lending many students will be the losers. Some people may not be able to go to school at all. Not everyone can choose to attend a school that is many miles from home. Direct lending may eliminate the availability of loans to some students. It will certainly increase default rates, which can cause schools to lose loan access. We should make sure all Americans have the opportunity for higher education, not make it harder for schools to offer assistance.

I am sure many others have done a more coherent job of discussing direct lending. However, I guarantee that anyone who thinks direct lending will benefit students or schools has not thought the system through.

Sincerely,

Pamela G. Jordan

Pamela G. Jordan
Financial Aid Director

OKLAHOMA · BAPTIST · UNIVERSITY

Office of Financial Aid

April 10, 1995

Representative Bart Gordon
6th District, State of Tennessee
2201 Rayburn Building
Washington, DC 20515-4206

Dear Representative Gordon:

Thank you very much for inviting me to respond to several questions you raised in your letter of March 22. Let me say how impressed I am with your knowledge of the student loan programs. Many times in the past, I have written to various members of Congress to express my concerns only to receive a response that left me wondering if they even read my letter, let alone understood what I was trying to say.

My institution's position on Direct Lending is the "let's wait and see" attitude. Our students are currently utilizing approximately $4 million annually through the Federal Stafford and Federal PLUS programs. Perhaps it's because Oklahoma is blessed with some fine lenders and a top-rate guarantee agency who are dedicated to continually improving service to the students. Or perhaps, like so many mid-westerners, we live by the philosophy of "Don't try to fix it if it ain't broke". It is our sincere belief that the private sector is doing an outstanding job to provide the capital required to fund so many student's only means to a college education. Yes, of course, they should be compensated for their services, but I am firmly convinced that what we are paying to lenders to provide this service is just a drop in the bucket compared to what it will cost for the government to attempt to provide those same services.

Mandatory participation? Can you name just one instance in which the American public happily accepted being forced into anything? I assure you, their reaction would be no different in this situation!

Thank you again for allowing me to express my opinion. I trust you will have no difficulty in deciding how I would like for you to cast your vote.

Sincerely,

Kay Vincent

Kay Vincent
Director of Financial Aid

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OKLAHOMA STATE REGENTS FOR HIGHER EDUCATION

State Capitol Complex
500 Education Building
Oklahoma City, Oklahoma
73105-4500

January 27, 1995

The Honorable Bart Gordon
United States House of Representatives
2201 Rayburn Office Building
Washington, D.C. 20515

FEB 02 1995

Dear Congressman Gordon:

Thank you very much for co-sponsoring the " Student Loan Evaluation and Stabilization Act" with Congressman Goodling. This legislation will enable Congress to make a genuine comparison of the Direct Loan Program and the Federal Family Education Loan Programs (FFELP).

The previous Congress made student loan policy decisions and considerations based on erroneous premises. Specifically, direct lending appeared to save money due to an anomaly in congressional budget scoring under the Credit Reform Act. Dr. Rudolph Penner, former Director of the Congressional Budget Office, has repeatedly denounced this particular budget rule as arbitrary and biased toward direct lending. In addition, Mr. Dennis Zimmerman and Ms. Barbara Miles, economists with the Congressional Research Service, have also raised questions about the alleged savings that were derived from the faulty assumptions.

The FFELP programs are an essential source of funding for students and parents. The FFLEP is a very successful program providing approximately $23 billion in loan funds each year to assist approximately 1.5 million students and parents finance higher education. Many positive changes have been made to the FFELP and, as a result of these changes, the programs are administered and funds are provided in a more efficient manner.

I am of the strong opinion that the FFELP program, utilizing private capital and promoting joint participation between private business and the Federal government, is a more efficient, more effective and less expensive method of providing funds to students and parents. I believe that the " Student Loan Evaluation and Stabilization Act" will provide Congress with the ability to make this determination and I wholeheartedly support its passage.

I appreciate the opportunity to provide this information. Please contact me if we can be of further assistance.

Sincerely,

Hans Brisch
Chancellor

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·STETSON·
UNIVERSITY

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April 27, 1995

The Honorable Bart Gordon
House of Representatives
2201 Rayburn Building
Washington, DC 20615-4206

Re: Your Letter of March 22

Dear Representative Gordon:

I appreciate the opportunity to give you my views on the FFELP vs. FDSLP controversy and commend you for your leadership in this initiative. Since 1967 I have been a practicing financial aid professional at public and private universities in both New York and Florida. During that time I have experienced many new Education Department initiatives not unlike the direct lending program. Thus I am not a proponent of direct lending.

Experience with the Education Department's track record predicts the following scenario: First the Department will initiate a major public relations campaign, touting how great everything will be. Then they will pull out all the stops and shift personnel from other areas within the Department to their new project. Next they will spoon feed the pilot schools, who will then applaud the Department's efforts. In the meantime, other programs administered by the Department will suffer, as will the quality of service to colleges and universities. Eventually the Department will make changes that will result in higher processing costs for colleges.

In fact, this scenario describes the Department's actual performance in administering the Pell Grant (formerly BEOG) Program. An example of the increased costs passed on by the Department is their decision to charge a school a $5.00 fee every time you call, write or fax them. There is no guarantee that you can get to talk to a person when you call. Usually we have to leave a voice mail message and wait for a response. You have to pay even when you have a technical problem. In addition, a $25.00 bookkeeping fee is charged to the school to process the school's payment! As you can see from the enclosed bill from the Education Department, schools even get charged for accessing the department's computer.

In reality, the schools have already incurred significant additional costs since they are doing more data entry which saves the Department from having to do this. Without question, a student loan program is far more complicated to administer than the Pell Grant Program. It would be easy for the Department to pass on additional costs to schools under direct lending, especially in an environment of increased budgetary concerns and an absence of competition from any other program.

On the surface the concept of direct lending appears to be fine. But there is a major problem since the Department is a monopoly that has a less than favorable track record when it comes to being responsive to the needs of students, colleges and universities. As a director of financial aid at a private institution, I simply cannot afford to take a chance on the Department's performance. The more the Department relies on subcontractors and the more they centralize, the more inflexible they tend to become. This results in a decline in the quality of service, much to the detriment of schools and students.

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After talking with many colleagues, I feel that many colleges opted for the direct lending program because they were dissatisfied with their state guarantee agencies, especially those which are run in a monopolistic or political environment. Interestingly, the Chancellor of the Board of Regents of the State University System of Florida has directed the public universities to use only the state agency and not a national guarantee agency. Two of the nine state universities opted for direct lending in the first year. Most private universities in Florida do not use the state agency since its performance is not competitive with the national guarantee agency. Most of these private institutions are not in favor of direct lending because they are well served by the national guarantee agency and by lenders.

I would like to emphasize that I am quite pleased with the FFELP because of the lender competition in Florida and because of the performance of the national guarantee agency we use. Our lenders have provided many valuable services to us through consumer publications, default management, counseling, regulatory interpretation and training. Lender competition has created a variety of options for schools, which helps us provide students and parents with a higher quality of services. This is very important since the Education Department can no longer afford to provide training to any significant degree.

I am also convinced that the Department has been less than candid in acknowledging the real cost to implement and administer FDSLP. It is distressing that Mr. Leo Kornfeld is unable or unwilling to devote any time to improving the FFELP, according to statements he made at a recent Advisory Committee on Student Financial Assistance hearing. The Department and Congress need to consider why the FFELP has become so over-regulated and micromanaged.

For several years, colleges have suggested that there be performance based regulations. Why should Stetson, which has a default rate under 5%, have to go through the same hoops as a school that has a default rate several times greater? Additional suggestions for improvement include having a single promissory note and not having to annually update information which doesn't change. Also, the annual loan amounts should be the same for all undergraduate grade levels, the loan amounts need to be increased, and the proration requirements should be eliminated. The proration regulations penalize students in their last semester of enrollment. It simply does not make any economic sense to impose this limitation on a graduating senior who is your best academic risk. Non-traditional students who have had to take a limited academic loan because they had dependents to take care of or because they found it necessary to work many hours per week in order to meet their financial obligations are often not able to graduate in an eight semester time frame and are penalized by proration. The old rule of 211 days or advancing a grade level was much more flexible and helpful.

It is also important that we preserve the in-school interest subsidy since students are already incurring large indebtedness and the loss of this benefit would add an additional 20-30% during the life of the loan. Unfortunately it is unrealistic to expect Congress to improve the current grant/loan imbalance at this time. Many students simply will not be able to enroll in college or the default rate could increase.

In summary, I am opposed to direct lending, but am in favor of H.R.530 if direct lending is not going to be repealed. However, it is essential that there be a fair comparison of both programs. Also, both programs must have the same features and level of Education Department support. The evaluation also has to extend into the repayment period, which is far more complicated than the disbursement process. Schools must continue to have a choice during the evaluation period without the political pressure that the Department is currently exerting.

I have tried to be very candid and am admittedly concerned about the Department's reaction to my statements. Please keep in mind that these are my personal opinions and not necessarily the official position of Stetson University. Thank you for taking the initiative for asking for the opinions of the financial aid community.

Sincerely,

John A Agett

John A. Agett, Director
Student Financial Planning

JAA/aj

Enclosure: Education Department Bill

FEDERAL I.D. NO. 41-[illegible]

AN EQUAL OPPORTUNITY EMPLOYER

INVOICE

[redacted]

ECEIVED
1995
Stetson University

Date: 03/24/95

Charge to Customer:
Customer Code: 2000115450 00832
Name/Address: JOHN B. STETSON UNIVERSITY
ATTENTION: JOHN A. AGETT

421 N. WOODLAND BLVD.
1 GRIFFITH HALL
DELAND, FL 32720

REMIT TO:
National Computer Systems, INC.
P.O. Box [illegible]
Iowa City, IA [illegible]

319/339-6442 - Customer Service

Contract Number: PN89032001
Requisition Number: 66241
Cust. Order Number: GES1365
Cust. Order Date: 02/02/93
General Order Number: E1011365

PLEASE INDICATE INVOICE NUMBER WHEN PAYMENT IS MADE

Terms: NET ON PRESENTATION

Page - 1

ITEM NO	QUANTITY	DESCRIPTION	PRODUCT CODE	UNIT PRICE	UNIT OF MEASURE	AMOUNT
		FY 1995 GES ELECTRONIC DATA EXCHANGE				
		REPORT PERIOD:02/27/95 - 03/26/95				
05248	2.00	GP6A EDI DATA TRANSMISSIONS PRIME	747009459	0.378	1000	0.76
05249	0.60	GP6B EDI DATA TRANSMISSIONS NON-PRIME	747009459	0.227	1000	0.14
05251	1.00	GP25 BILLING SYSTEM OPERATIONS	747026459	25.00	1	25.00
					INVOICE TOTAL	$25.90

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Mississippi State
UNIVERSITY

Office of the President

May 12, 1995

The Honorable Bart Gordon
House of Representatives
2201 Rayburn Building
Washington, DC 20515-4206

Dear Rep. Gordon:

Thank you for your recent letter concerning federal student loan programs.

We at Mississippi State University support continuation of the Federal Family Education Loan Program, which has provided good service to our students. We have seen improvements in the program during the past year which may have resulted from the element of competition represented by direct lending.

We believe there is also a place in the current financial aid structure for the Federal Direct Student Loan Program, although we would urge caution is proceeding with a large-scale, rapid increase in this relatively untested program. We would prefer that both programs be continued at least for the next two or three years, with Direct Loans capped somewhere in the range of 40 to 60 percent of new loan volume.

The two-program approach would allow colleges and students to preserve their loan options while providing the opportunity for a thorough evaluation of direct lending. We would not favor mandatory participation in direct lending. Sustained competition between the FFEL and the FDSL programs should provide incentives for continued improvements in financial aid offerings.

Thank you for your concern for the future of educational opportunity.

Sincerely,

Donald W. Zacharias
President

c: Dr. Roy Ruby

P.O. Box J • Mississippi State, MS 39762-5509 • (601) 3221 • FAX (601) 325-3189

ASSOCIATION OF VERMONT INDEPENDENT COLLEGES
Two Prospect Street • Montpelier, Vermont 05602 • 802-223-1662

21 February 95

The Honorable Bart Gordon
103 Cannon House Office Building
1st and Independence Avenues, S.E.
Washington, D.C. 20515

Dear Representative Gordon:

This is written on behalf of the members of the Association of Vermont's Independent Colleges. Our 17 schools enroll some 15,000 students.

The introduction of H.R. 530, titled the "Student Loan Evaluation and Stabilization Act of 1995" is both valid and appreciated.

In today's economy, students of all ages need the choice of how they want to consolidate their loans. They need: the provisions of "one-stop-shopping". That is, a simplified process for loan applications; guaranteed similar treatment regardless of the loan program option chosen and credit eligibility standards which are similar for each option.

The Association recommends that Direct Lending be treated as a pilot project and capped at 40% of annual volume until such time as testing and evaluation can be completed. In addition, we further recommend removing the Department of Education's authority to force schools to participate in direct lending.

Your leadership in this critical area is appreciated. When enacted into law, it will promote equity for borrowers, ensure the proper accounting of program costs and afford proper evaluation of the Direct Loan Program.

If there are ways in which this office can be of assistance, please advise.

Sincerely,

Alan

Alan H. Weiss
Executive Director

cc: Senator James M. Jeffords

West Virginia School of
Osteopathic Medicine

March 27, 1995

The Honorable Bart Gordon
House of Representatives
Congress of the United States
2201 Rayburn Building
Washington, DC 20515-4206

Dear Representative Gordon:

Thank you for your letter of March 22, 1995 requesting information on how schools feel concerning the Direct Loan program.

I have many concerns about direct lending. I do not feel that it should be a mandatory program for schools. I do feel however that if a school chooses to participate, they should be allowed to do so. In essence, there should be no minimum number of schools required and no maximum number allowed in the program. Each school is diversely different on its processing of loans for students, therefore, it should be up to each school if they want to participate or not.

We are a professional school and are quite satisfied with the service our school receives under the FFEL program. I do believe that the service the students receive after graduation could be improved if there were stringent regulations placed on servicers. Many servicers are unwilling to work with students when they get in a financial crunch.

I agree with your points concerning the direct lending program. Until it has been in existence for a least ten (10) years there are no indicators to judge the success of the program. The Department of Education has not demonstrated that they will be able to handle the collection and servicing of loans at this point.

If I can be of any further assistance, please let me know.

Sincerely,

Sharon L. Howard

Sharon L. Howard
Director of Financial Aid

400 North Lee Street Lewisburg, West Virginia 24901 304•645•6270 Fax 304•645•4859

OFFICE OF THE PRESIDENT
THE UNIVERSITY OF TEXAS AT AUSTIN

P.O. Box T · Austin, Texas 78713-8920
(512)471-1232 · FAX (512)471-8102

April 7, 1995

The Honorable Bart Gordon
The United States House of
  Representatives
2201 Rayburn Building
Washington, DC 20515-4206

Dear Mr. Gordon:

Thank you for the opportunity to comment on student loan processing via either the Federal Direct Loan Program or the Federal Family Education Loan Program. You asked that I address the following specific questions:

1. What is your position on Direct Lending and the reasons for your position?

   The University of Texas is supportive of the Direct Lending Program as an alternative to FFELP. It is important to note that the Direct Lending Program gives many institutions a choice regarding which processing system works best at a particular institution. The University of Texas at Austin has a unique processing environment, using an institutionally developed mainframe financial aid software in concert with a local area network of Macintosh microcomputers. This unique processing platform has caused us to choose to delay implementing the Direct Lending Program. This delay will allow us to extend our opportunity to evaluate the Direct Lending Program.

2. How do you feel about mandatory participation in Direct Lending?

   One of the benefits of the implementation of the Direct Lending Program has been increased competition faced by private enterprise. In response to this increased competition, private enterprise has moved vigorously to explore new avenues and cooperative ventures in the processing of students' loan applications. We are not in favor of mandatory participation in Direct Lending because we feel that competition brings a higher level of service. A federally mandated Direct Lending Program is unlikely to provide the options that would allow the most efficient responses by the University of

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Texas at Austin and other institutional participants nationwide.

3. Are you satisfied with the service your school and students receive under the Federal Family Education Loan Program and how do you believe it could be improved?

While the current processing at The University of Texas at Austin is satisfactory and we are, therefore, reasonably satisfied with the service that we are receiving, we believe that the Texas Guaranteed Student Loan Corporation and others that continue to operate in the FFELP arena will continue to respond to UT Austin's unique needs enhancing the level of service available both to the institution and its students. We feel that this improvement has developed naturally as these entities have continued to seek an improved level of service. However, as indicated above, the substantial competition of Direct Lending has caused these entities to move with greater vigor and interest than they might otherwise have exhibited.

One extremely important area in which the FFELP process could be improved (and all other areas of processing student support) would be to enact legislation that would provide a differing level of reward/reprimand for institutions based on their performance. The current status of federal legislation is that there is limited variability in the degree of mandated activities. Institutions doing an excellent job at serving their students' needs within the federal audit requirements and with excellent outcomes in the area of student graduation rates, success rates and employment rates, still fall under a heavy handed (and expensive) regulatory burden. I am enclosing a document produced by the University of California Financial Aid Directors regarding regulatory relief for quality institutions. Dr. Lawrence Burt, the current Director of the Office of Student Financial Services at the University of Texas at Austin was a primary author of that document and would be happy to provide additional information regarding this topic should you wish.

The University of Texas at Austin supports cost cutting measures and movement toward a balanced federal budget. There is much discussion in the media surrounding cuts in various federal programs. While there are many programs that may be appropriate for an intense level of scrutiny (and perhaps funding reductions), I must request that you look carefully at all of the options available to you prior to enforcing draconian measures in the area of student financial support.

Education is the key to advancement, particularly for economically disadvantaged and minority students. Your support in providing opportunity for needy students is requested. Thank you for providing a forum in which the comments of educational leaders can be aired.

Sincerely,

Robert M. Berdahl
President

RMB:LWB:dab

Enclosure

c: Lawrence W. Burt

DISCUSSION DRAFT: CORRELATION BETWEEN ADMINISTRATIVE QUALITY AND REGULATORY RELIEF

RANKING	MINIMUM QUALITY CRITERIA	GENERAL QUALITY CRITERIA	REGULATORY RELIEF
AAA	Minimum for category: 1) Stafford cohort default rate of less than 12.5%. 2) No more than 75% of total enrollment on need-based federal aid. 3) Absence of LS&T activity against the institution by ED, currently or within preceding 5 years. 4) Meets at least 4 of the criteria listed in "General Quality Criteria." 5) Five consecutive years of participation in Title IV programs. 6) Has not had findings in the preceding two external SFA audits that resulted in paybacks totaling more than 2% of Title IV disbursements for the audit year in question. 7) Spends an amount greater than 3% of its Title IV funds on the administration of financial aid.	General quality criteria apply to AAA- and AA-ranked institutions: 1) Participates in at least 2 of the 3 campus based programs. 2) Admits less than 2.5% of undergraduates by ability-to-benefit. 3) Has institutionally funded student support programs that equal at least 5% of the average total amount awarded at the institution in Title IV aid over the preceding 3 years (excluding SLS & PLUS and including any overmatch contributed to campus-based programs). 4) Is a member of a state, regional or national professional association focused on the delivery of need-based financial aid. 5) Participate in Dept. of Ed. QA program.	Waived: 1) 30-day delay in disbursement of Stafford Loans for first-time UG borrowers. 2) Specific requirements regarding entrance and exit interviews for Stafford and Perkins borrowers. 3) Multiple disbursements in Stafford Loan Program. 4) Collection of the Financial Aid Transcript. Modified: 1) Quadrennial instead of biennial SFA external audits. 2) Reduce verification requirements. 3)Professional judgment: permit its application to categories of students.
AA	Minimum for category: 1) Stafford cohort default rate of less than 17.5%. 2) No more than 85% of total enrollment on need-based federal aid. 3) Absence of LS&T activity against the institution by ED, currently or in preceding 5 years. 4) At least 4 of the criteria listed in "General Quality Criteria." 5) 3 consecutive years of participation in the Title IV programs. 6) Has not had findings in the preceding two external SFA audits that resulted in paybacks totaling more than 4% of Title IV disbursements for the audit year in question. 7) Spends an amount greater than 2% of its Title IV funds on the administration of financial aid.		Waived: Same as AAA institutions except #3 (multiple disbursements in Stafford Loan Program) would continue as a requirement. Modified: 1) Professional judgment: permit its application to categories of students.
A	All other institutions that meet basic federal standards for participation in Title IV programs.		No waivers No modifications

UNIVERSITY OF
SOUTH CAROLINA

April 4, 1995

The Honorable Bart Gordon, M.C.
2201 Rayburn Building
Washington, D.C. 20515-4206

Office of Student Financial Aid
and Scholarships

Dear Congressman Gordon,

Thank you for taking the time to make covert effort to understand the issues involved in the Direct Loan/Federal Family of Educational Loans.

Your letter is very much to the point as will be my response. I believe that in the absence of a strong state guarantee agency the Direct Lending Program would be my choice. However in South Carolina, as in Tennessee, there is a strong, well managed Agency that has made the effort to be responsive to the needs of the schools, supportive of student benefits and very service oriented. The South Carolina Student Loan Corporation has all of the benefits of direct lending including all of the repayment options so prominently mentioned by proponents of Direct Lending. In addition, it is offering the Great Rewards benefit. In short, I am pleased with FFELP. At best Direct Lending might equal what we do now, and if that is the best it can do, why change?

A second reason we wish to stay as we are is the additional programming required of our computer center.

Finally, I am not convinced the Education Department can provide the services required of a lender for fund management, distribution of funds and requisite reporting of information. Clearly, there would be a need for a costly enhancement of staffing and technology.

I think mandatory Direct Lending would be a mistake. We are told that the default rate will not be factored in the evaluation of the school and its participation in the program. The old saying that a "defaulted payment is only a bad loan matured" would surely impact, and blame for defaults will be placed. Competition from Direct Lending has made the FFELP a better program. Conversely, Direct Lending will be a better and more effective program by competing.

In short, I believe the system of Direct Lending must be given several tests of viability and capability. One hundred and four schools are very pleased. Will 1,400 schools be equally as pleased? More to the point, will 7,000 schools be pleased? I

An Affirmative Action / Equal Opportunity Institution

believe Direct Lending must be well tested.

I hope my responses will be of assistance as you look to the legislation supporting students. If I may be of service to you as this matter is considered, please feel free to call on me.

Sincerely,

Gerald T. Bird, Director
Financial Aid and Scholarships

CLEMSON
UNIVERSITY

DIRECTOR
STUDENT FINANCIAL AID

April 3, 1995

The Honorable Bart Gordon
Member of Congress
House of Representatives
2201 Rayburn Building
Washington, DC 30515-4206

Dear Congressman Gordon:

We acknowledge your letter of March 22, 1995, regarding Clemson University's position on the Direct Lending Program with great appreciation.

As Director of Financial Aid for Clemson University for the past twenty years and having served in several regional and national leadership roles, I have been consciously aware of issues regarding direct lending. I am not opposed to direct lending, but I want to ensure that the program performs as having been suggested by its proponents. I favored a pilot program rather than mandatory participation to allow ample evaluation. The phase-in accomplishes this objective, but a sense of urgency seems apparent by the Department of Education to insure that the concept works. As you are aware, substantial resources have been directed toward this effort. I would question whether such attention would have been given to support institutions with mandatory participation and if such attention will continue. Clemson University currently has limited resources to install a new system which would be essential during the formative stages of direct lending.

Conversion to direct lending is not cost effective for Clemson in the current financing environment and would be no more beneficial to our students. Direct lending requires that the institution process the application and cover the cost of managing the promissory note. Under the Stafford Loan model that we follow, we have an electronic relationship with the South Carolina Student Loan Corporation which guarantees loans, serves as the lender, and services loans. The majority of our loans are processed through the Corporation. The Corporation receives data electronically from Clemson University. The Student Loan Corporation manages the promissory note process, approves loans and electronically informs Clemson of the approval. Funds are forwarded electronically prior to student enrollment to allow time for reconciling and for the opportunity to generate electronic funds transfer float revenue.

G01 SIKES HALL • BOX 345123 • CLEMSON, SOUTH CAROLINA 29634-5123 • TELEPHONE 803/656-3431 • FAX 803/656-1831

Although direct lending provides a limited administrative allowance, additional administrative costs makes the program less attractive than the currently streamlined Stafford Loan program process. Direct lending has provided major incentives to the Stafford Loan industry to maximize efficiency and enhance program attractiveness.

Mandatory participation in direct lending would be a mistake. Participation should be voluntary based on the merits of each. If direct lending is truly more economical and administratively more attractive, time should be allowed for the program to be proven. I am convinced that the program can work and be successful. I am not convinced of the level savings and how supportive the Department will be in the long run. Guarantee agencies and lenders serve as advocates for the Stafford Loan Program insuring efficiencies including regulatory. I am concerned about how effective and efficient a government-run/controlled program will be in the long run.

The issue of loan limits and interest benefits must be given careful consideration. Reliance on loans is reaching a level which must be given your attention. Loan limits currently do not ensure educational access. The cost of attendance for a freshman at Clemson University, a state supported institution, is $10,446 for 1995-96. With the Pell Grant and Stafford Loan, we can only assure a student of $4,975 minus loan fees. I would also encourage caution in discussion regarding in-school interest subsidies, which if relinquished for needy students would have the effect of increasing loan repayment by 20% to 30% while borrowing at the same level. Default level issues will be a major concern in the future.

Your interest in this issue is greatly appreciated. Should additional information be needed, do not hesitate to call on me.

Sincerely,

Marvin G. Carmichael
Director of Financial Aid

MGC/cc

xc: Congressman Bob Ingles
Congressman Lindsey Graham
Dallas Martin
Senator Strom Thurmond
Senator Fritz Holling

Charleston Southern University

FINANCIAL AID

March 30, 1995

The Honorable Bart Gordon
2201 Rayburn Building
Washington, DC 20515-4206

Dear Representative Gordon:

Thank you for the opportunity to address some of the issues regarding the federally supported student loan programs. Your interest in and support of student aid is greatly appreciated.

In answer to your questions:

1) I am opposed to direct lending. There are numerous reasons. A few are: 1) Why would we put all our "eggs in one basket" when we do not know if the "basket" has holes? The Federal Family Education Loan Program is tried and true. Charleston Southern is a small (2500 student population), private college, the computer support and clerical support would present mammoth problems. 2) With the costs of education rising at alarming rates, and federal aid being reduced, it is impossible to package a full-need student without using loans. CSU has packaged with FFEL for years. This has been an extremely workable system. Why stop? 3) There are no guarantees about default rates in the Direct Loan program. What if our college is "assigned" an outside servicer who does not do a good job following-up with students and consequently our college has a large default rate thereby loosing the Direct Loan funding! If the FFEL Program is not available, how will students afford to attend our college?

2) I adamantly oppose mandatory participation in direct lending. To begin with, where is all the money coming from to fully fund all students? At CSU, we currently have approximately $6 million in FFEL funds. We represent just one small school!

3) Yes, I am completely satisfied with the service CSU and our students receive. In South Carolina, we utilize the South Carolina Student Loan Corporation for approximately 95% of all FFEL programs. The Loan Corporation has the lowest default rate in the nation. Why would I not be satisfied? When I came to Charleston Southern University, the majority of loans where processed through outside lenders. The first default rate reported at CSU was 37%! The first thing I did was

[illegible] UNIVERSITY BOULEVARD
POST OFFICE BOX [illegible]
CHARLESTON, SOUTH CAROLINA [illegible]
[illegible]

"Academic Excellence in a Christian Environment"

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to contact the Loan Corporation and start sending all new application to them. They have worked with my staff to correct any problems and have provided exemplary service to both my staff and our students. I am extremely proud to say that the current default rate at CSU is less than 7%! A program that works with a lender that is supportive and conscientious. The Loan Corporation is always seeking ways to better assist both the institutions and the students. They have been aggressive in seeking new technology to speed processing and limit paperwork.

These are just a few of my concerns and issues regarding student loans. I am truly grateful that you have taken the time to listen! That does not always happen in Washington. Thank you. If I can be or further assistance to you in any way, please feel free to contact me.

Sincerely,

Ellen Carraway Green

Ellen Carraway Green
Director
Financial Aid

cc: Mr. William M. Mackie, Jr.
Executive Director, SC Student Loan Corporation

SOUTHERN
WESLEYAN
UNIVERSITY

Wesleyan Drive • P.O. Box 1020
Central, SC 29630-1020

(803) 639-2453 - (803) 639-0826 FAX

March 27, 1995

The Honorable Bart Gordon
House of Representatives
2201 Rayburn Building
Washington, DC 20515-4206

Dear Representative Gordon:

Thank you for your letter dated March 22, 1995. It is encouraging to know that we have Representatives in Congress that are willing to go the "extra mile" in finding out the views of American citizens.

As Director of Financial Aid at Central Wesleyan College, I am very aware of all the proposed changes to higher education. The implication that all schools will eventually be forced to go with Direct Lending is an alarming thought.

From an administrative standpoint, I do not feel like Direct Lending will be that much more difficult. My concern is for my students. Schools that are participating in Direct Lending presently seem to favor this method of lending. The DOE has been able to give those schools terrific service. But what happens when the number of schools triple? Will they still be able to handle the volume with the same type of service? I don't think it's possible. Different "bugs" are bound to appear once all schools are involved with D.L. This system is too new and hasn't really been tested yet.

Also, very little has been said or published regarding the way students will be handled once they are in repayment, etc. I don't have any way of knowing whether or not my students will get the same service through Direct Loans as they would through the FFEL program. This system needs to be tested for many years on a much smaller scale before all schools are forced into these uncharted waters.

I look at it this way: I would not buy a car from a new dealership who did not have their service garage built yet. Imagine how you would feel if you asked the salesman how he planned on servicing your car and he told you he would worry about that when the time comes. Suppose too, that there was an experienced dealership just down the road with proven service and years of experience. Where would you buy your new car?

Mandatory participation in direct lending would take away the freedom of choice that schools and students now have. My students like to "shop around" for lenders with superior customer service. If the DOE didn't have any competitors, there would be no need for them to strive for higher levels of customer service. Competition is one of the ingredients that have made American businesses so appealing to consumers. Having a monopoly on the student loan program would not be just. It goes against many of

A quality education, a Christian perspective the values congress has tried to instill in American businesses for years.

Lastly, I am very satisfied with the current FFEL program. I do feel though, that the Department of Education gives little support to schools considering the magnitude of the rules and regulations handed down. Moving towards mandatory participation in the Direct Loan program would make a bad situation worse.

Again, thank you for your awareness to problems such as these. I would be happy to provide you with as much information as needed to support your fight.

Sincerely,

Ben Milstead

Ben Milstead
Director of Financial Aid

PENNSTATE

(814) 865-5431
FAX (814) 863-8476

Bob L. White
Director of Legislative Affairs

The Pennsylvania State University
117 Old Main
University Park, PA 16802-1501

March 30, 1995

The Honorable Bart Gordon
Congress of the United States
House of Representatives
2201 Rayburn Building
Washington, DC 20515-4231

Dear Mr. Gordon:

This is in reference to your letter of March 22 to Dr. Joab Thomas, President of The Pennsylvania State University, concerning the issue of direct lending.

I am enclosing a copy of a letter that we recently sent to Chairman Goodling on this topic. I believe this correspondence addresses the questions that you raise. If you need further assistance, please let me know. Thank you for your support!

Sincerely,

Bob

Bob L. White

Enclosure

PENNSTATE

Joab Thomas
President

The Pennsylvania State University
201 Old Main
University Park, PA 16802-1589
814-865-7611
814-863-8583 (Fax)

January 30, 1995

The Honorable William F. Goodling
United States House of Representatives
2263 Rayburn House Office Building
Washington, D.C. 20515-3819

Dear Mr. Chairman:

I write in support of your effort (H.R. 530) to provide for a careful evaluation of the Direct Lending Pilot Program. I note that your legislation will allow for careful evaluation and comparison of the Federal Family Education Loan Program and the Federal Direct Student Loan Program by restoring the Federal Direct Student Loan Program to a true "pilot" status, thus allowing both programs to operate until an adequate evaluation can be made.

Common sense dictates that with a program of this magnitude Congress must be certain that any new program will operate effectively both fiscally and administratively if it is to serve the best interests of our Nation's students.

Your legislation will take this issue out of the realm of politics and will allow future discussions to be based upon facts rather than rhetoric.

I congratulate you on your leadership of this vital issue.

Sincerely,

Joab Thomas

Joab Thomas

Oregon
Institute of
Technology

Office of Student Financial Aid

3201 Campus Drive, Klamath Falls, OR 97601-8801 / 503.885.1280 / FAX 503.885.1024

March 29, 1995

Honorable Bart Gordon
2201 Rayburn Building
Washington, D.C. 20515-4206

Dear Representative Gordon:

Thank you for your letter regarding my position on H.R. 530. I very much support the resolution and have sent letters indicating my position to all the Oregon Congressional delegation. A copy of that letter is attached which addresses the points you are most concerned with. Our relationship over many years with the private sector in the student loan program has been very successful and beneficial to our school and to our students. Frankly, I do not believe the Department of Education will ever be able to provide the same level of services on either end of the student loan program as has the private sector. We have carefully evaluated and chosen quality lenders, guarantors, and servicers for our students and it has worked well. I hope to always have that as an option for them. If you or your staff have additional questions please contact me.

Sincerely,

John C. Huntley

John C. Huntley
Director of Financial Aid

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